

# NAVAL POSTGRADUATE SCHOOL

## Monterey, California



## THESIS

**THE FISCAL YEAR 1999 OUTLAY ESTIMATE  
DIFFERENCE BETWEEN THE DEPARTMENT  
OF DEFENSE AND THE CONGRESSIONAL  
BUDGET OFFICE**

by

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June 1999

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BETWEEN THE DEPARTMENT OF DEFENSE AND THE  
CONGRESSIONAL BUDGET OFFICE**

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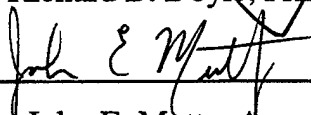


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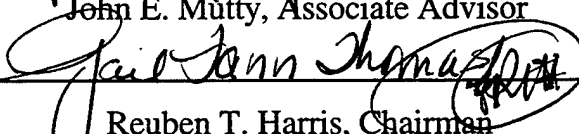
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## ABSTRACT

This thesis focuses on the emergence and resolution of the outlay estimation problem associated with the development and enactment of the fiscal year (FY) 1999 Department of Defense (DoD) budget. During the budget development process, the Congressional Budget Office (CBO) estimated DoD FY99 outlays to be \$3.7 billion higher than estimates submitted by DoD, which would have caused DoD spending to exceed FY99 defense spending targets established in the 1997 Balanced Budget Act (BBA). Four factors produced the \$3.7 billion outlay estimate problem. These include DoD's Working Capital Fund (WCF) policies, the overall outlay estimating process, the analytical techniques used to estimate outlays, and the inherent variability within DoD's many programs. The issue was resolved by key decisions taken in the Senate that generated outlay savings within the budget, implemented through legislative provisions and member assurances. \$1.3 billion in outlay savings were achieved in WCFs, \$700 million as a result of administrative initiatives within two classified Air Force accounts, \$737 million from DoD asset sales, and \$190 million was saved based on the transfer of Operations and Maintenance funds to the Pentagon Renovation Transfer Fund.



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## **I. INTRODUCTION**

### **A. BACKGROUND**

Congress' increasing difficulties in controlling government expenditures has led to significant budget process reforms over the past 20 - 25 years. The Congressional Budget and Impoundment Control Act of 1974 (CBA) established the Congressional Budget Committees and the resolution process in an attempt to procedurally control government spending. However, growing annual deficits (outlays in excess of revenues) throughout the 1970s and early 1980s led Congress to enact additional statutory changes to its budget process. The 1985 Gramm-Rudman-Hollings (GRH) Act attempted to force the executive and legislative branches to attain specific deficit reduction goals. The intent was to achieve agreed upon deficit targets for each year, eliminating the deficit within five years. If targets were missed, the President was required by law to make across-the-board spending cuts called sequestration. GRH legislation failed to achieve its objectives, primarily because the majority of federal spending was exempted from the sequestration rules. Consequently, annual deficits continued to grow.

In the early 1990s, Congress changed its fundamental focus concerning budget process reforms designed to reduce the deficit. Where GRH emphasized bottom-line deficit reduction targets, the Budget Enforcement Act (BEA) of 1990 focused on spending control. (Doyle and McCaffery, 1991) This method was much more realistic concerning program funding requirements and it also



highlighted the importance of maintaining sufficient revenue levels. For example, discretionary spending caps were set over several years for defense, domestic, and international programs based on "reasonable," policy-based, spending levels. This contrasts sharply with a sequestration rule that arbitrarily cut these programs when procedural and political impasse materialized during the budget process. On the revenue and entitlement side, BEA legislation initiated the pay-as-you-go (PAYGO) procedure, whereby any proposed tax reduction or increase to mandatory programs, e.g., Medicare/Medicaid, had to be offset by tax hikes or reductions in other mandatory programs. Under this new legislation, aided significantly by the end of the Cold War and a strong economy, the deficit had been eliminated by the end of FY98.

Under current budget rules and legislation, the congressional budget, authorization, and appropriation committees rely on CBO estimates to "score" compliance with spending limitations. Differences between FY99 CBO estimates of defense outlays and those generated by DoD created significant problems for the congressional committees and DoD. On 2 April, 1998, Senator Pete Domenici, Chairman of the Senate Budget Committee, received a joint memorandum from the Directors of the Congressional Budget Office (CBO) and the Office of Management and Budget (OMB) concerning the Department of Defense (DoD) FY99 Budget. This memo informed the Chairman that the CBO estimate of DoD's FY99 outlays associated with the President's proposed budget was \$3.7

billion higher than the Department's estimate. (Raines and O'Neil, 1998) Under the CBO estimate, the Department's outlays would exceed FY99 defense spending targets established in both the Senate-passed FY99 Budget Resolution and the 1997 Balanced Budget Act (BBA).

In order "to bring bills to the floor that comply with the outlay constraints of the BBA, the Defense Committees can either (1) restructure defense programs to reduce outlays, (2) cut total defense budget authority, or (3) take other steps, with the approval of the Budget Committees, to alleviate the problem." (Daggett, October 1998) Significant adjustments to DoD's FY99 Budget would be required if CBO's estimate was to prevail. Congressional and DoD experts agreed that such adjustments "would have a devastating impact" on near-term defense readiness. (U.S. Senate, April 1998)

Alternative one would require a complete restructuring of the FY99 defense budget by reducing "funding in areas that spend-out quickly while increasing funding in areas that spend-out more slowly." (Daggett, October 1998) This alternative raises significant defense readiness and morale issues within Congress and the Department. Reducing the FY99 "quick spending" appropriations, i.e., O&M and Personnel, would have immediate impacts on training, equipment readiness, and compensation related activities. Secretary of Defense Cohen, in a March 24, 1998 memo, indicated that the potential reduction would have a severe and "unacceptable" impact on our current military readiness. (Cohen, 1998)

Cuts to DoD's FY99 budget authority, alternative two, could also significantly impact DoD due to the magnitude of cuts required to achieve the necessary outlay adjustments. Since only 60 percent of new Budget Authority (BA) is spent in the first year, across-the-board cuts in BA greater than \$6B would be required to achieve the necessary outlay savings. If the committees try to limit the impact on the O&M and Personnel Appropriations, the magnitude of BA cuts in the investment accounts, e.g., procurement, would have to be even greater. (Daggett, October 1998)

Finally, the congressional defense committees could seek help from the Budget Committees. In essence, the defense committees could seek an adjustment to defense outlay targets and/or movement away from exclusive use of CBO estimates to score outlay compliance.

## **B. RESEARCH OBJECTIVES AND QUESTIONS**

My research focuses on the emergence and resolution of the outlay estimation problem associated with the development and enactment of the fiscal year (FY) 1999 DoD Budget. During the budget development process, the CBO estimated DoD FY99 outlays (dollars drawn from the U.S. Treasury) to be \$3.7 billion higher than estimates submitted by DoD. My research identified and analyzed the primary causal factors associated with this discrepancy and how it was resolved.

My primary research question was: What was the cause of a significant difference between DoD and CBO in estimating the outlays associated with DoD's FY99 budget estimate submission? And, how was this problem resolved?

Subsidiary research questions were as follows:

1. What are the definitions of "budget authority" and "outlays" as they relate to the federal budget? What is their significance for spending constraints?
2. How are spending constraints related to the outlay estimate problem?
3. What is the history of DoD/CBO outlay estimate problems? How have they been resolved?
4. What is the account-level breakdown of the FY99 outlay estimate problem?
5. What was the final outcome/solution of the FY99 outlay estimate problem?
6. Have new policies/procedures been implemented as a result of the FY99 outlay estimate problem?

### C. SCOPE

The management process by which the DoD budget is developed and enacted comprises a highly complex mix of procedural and political elements. Two fundamental objectives drive the DoD and congressional budget processes: (1) to provide the Commanders in Chief (CINCs) with the best mix of forces, equipment, and support; and (2) to achieve spending goals designed to contribute to deficit reduction and the ultimate strengthening of the U.S. economy. (Zimmer, 1996) The FY99 outlay estimate differences between DoD and CBO illustrated a

problem within these processes. To fully examine the issues contributing to this problem, both procedural and political elements within DoD, OMB, and the legislative branch (to include CBO) were analyzed. Although the process and issues are complex, the FY99 estimate problem is specific and will thus limit the scope of my study.

## **D. METHODOLOGY**

Outlining my data requirements and analytical approach best summarizes the methodology that was followed:

### **1. Data Requirements**

Factual and analytical material on the FY99 outlay estimation problem were not difficult to obtain. The outlay estimate problem represented a significant FY99 budget issue due to the size of the difference between DoD and CBO, i.e., \$3.7B, and the potential impact on military readiness or investment. Accordingly, much has been written concerning the topic.

### **2. Data Analysis Approach**

The amount of data on the FY99 outlay problem is substantial. In addition, given the political framework that underscores all budget issues, balancing "opinion" sources in order to ensure an objective analysis was necessary. Therefore, I constructed the following framework to assess the data I accumulated:

a. I attempted to divide all incoming data into two primary categories; those materials that were primarily process oriented and descriptive in nature and those that seemed open to political interpretation. The intent here was

to separate facts driven by current regulations and directives and opinion data open to political assumption and interpretation.

b. My detailed analysis focused on the “process” materials and initially addressed those portions of the budget where the outlay estimate problem was the largest. For example, the WCF<sup>1</sup> and the RDT&E, AF<sup>2</sup> accounts represented only two of the ten accounts that made up the outlay estimate problem, yet they represented over 56 percent of the \$3.7B problem. Using my approach from (a) above, I focused on OSD/OMB and CBO data elements that captured the process, procedures and assumptions that drove each of their outlay estimates.

c. Finally, I analyzed how the FY99 problem was resolved and the solution’s implication on future outlay estimate problems.

## **E. ORGANIZATION OF THE STUDY**

Chapter I: Introduction. This chapter provides an overview of the FY99 outlay estimation problem and summarizes my research method and questions.

Chapter II: The Development, Review, and Enactment of the DoD Budget. This chapter describes the management control and political processes used to develop, review, and enact the DoD budget. Major elements of the processes are explained including DoD’s development of their budget estimate, the review and compilation of that estimate by OMB, and the congressional review and enactment process.

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<sup>1</sup> WCF: Working Capital Fund.

<sup>2</sup> RDT&E, AF: Research, Development, Test & Evaluation, Air Force.

Chapter III: The FY99 Outlay Estimation Summary Data. This chapter breaks down the FY99 outlay estimation problem by applicable account. My intent was to highlight and focus on those accounts in which the outlay problem was most severe. A general explanation of each account is provided since the nature of each is a potential contributory factor to the outlay problem.

Chapter IV: Process Factors Associated with the FY99 Outlay Estimation Problem. This chapter focused on OSD/OMB and CBO data elements that captured the process and assumptions that drove each of their outlay estimates. The focus was on published policy and rules, supplemented by information obtained from interviews and written communications with officials involved in these issues.

Chapter V: Process Solutions and Future Implications. This chapter assesses and summarizes the relative causal factors associated with the FY99 outlay estimation problem and how the problem was ultimately resolved. Prior-year outlay estimate problems and solutions were explored to determine if significant and relevant patterns existed. Implications for future outlay estimation problems were identified.

Chapter VI: Conclusions and Recommendations. This chapter summarizes previously developed issues and my findings. I also provide potential topics for additional research.

## **F. BENEFITS OF THE STUDY**

I sought to fully explain the significant causal factors associated with the FY99 DoD/CBO outlay estimate difference and how the problem was ultimately resolved. Congress has repeatedly reformed the budget process in order to “procedurally” control their fiduciary responsibilities. However, the U.S. political system is highly fragmented, thus, it seems heavily resistant to centralized power and “procedural” efficiency. By documenting and analyzing the causal factors associated with the FY99 estimation problem, our civilian and DoD leadership will be better able to anticipate, address, and possibly avoid future outlay estimate problems and the significant budget/readiness problems they represent.





## **II. THE DEVELOPMENT, REVIEW, AND ENACTMENT OF THE DOD BUDGET**

### **A. INTRODUCTION**

The DoD budget reflects this government's choices among competing national security priorities. The process by which this document is developed and enacted is highly complex. However, its defined purpose is straightforward – “to provide the CINCs with the best mix of forces, equipment, and support that is attainable within fiscal constraints.” (Zimmer, 1996)

Federal budgeting consists of four main phases: (1) preparation and submission of the budget by the President to Congress; (2) the congressional enactment process; (3) execution of “budget-related” laws by federal departments; and (4) audits of agency spending. (Oleszek, 1996) This thesis focuses on the first two phases and describes the key elements and management control mechanisms by which the DoD portion of the President's budget is developed and approved via congressional action.

Several actions summarize the first two phases of federal budgeting, as they relate to DoD. The first step is the budget phase of DoD's Programming, Planning, and Budgeting System, which includes command and agency budget estimate submissions (BESs) and the Office of the Secretary of Defense (OSD) review process. “As agencies formulate their budgets, they maintain continuing contact with the OMB examiners assigned to them. These contacts provide

agencies with the guidance in preparing their budgets and also enable them to alert OMB to any needs or problems that may loom ahead.” (Keith, 1997) Agencies submit their final budget estimates to OMB in late summer or early fall, following which they are “reviewed by OMB staff in consultation with the President and his aides.” (Keith, 1997) The final President’s budget is submitted to Congress no later than the first Monday in February.

The second phase of federal budgeting is the congressional enactment process, which includes the budget resolution, authorizations, and appropriations. If Congress changes entitlement spending or revenues, it will also enact reconciliation legislation. With the exception of the budget resolution, all congressional budget bills must be approved by the President.

#### **B. DOD BUDGET ESTIMATE SUBMISSION (BES) AND REVIEW**

The purpose of DoD's budgeting phase is to translate programmatic decisions into “detailed” resource requirements consistent with the appropriation format required by Congress. The budgeting phase begins when field operating commands and DoD agencies provide their BESs and accompanying justification in accordance with program guidance, resource limitations, and decisions made by the President and passed to the services via the Secretary of Defense.

BESs are then reviewed jointly by budget analysts within OSD and OMB. During this review process, hearings are held to assess conformity of the services’ BESs with previously provided programming guidance and decisions. Program

Budget Decisions (PBDs) will ultimately be signed by the Deputy, Secretary of Defense (DEPSECDEF) or the OSD Comptroller in order to adjust the services' BESs. Normally, draft PBDs are released by the OSD staff prior to final signature which allows the services a chance to "reclama" a proposed PBD. The reclama process is designed to give the services a chance to provide supplemental information that challenges the basic argument of the proposed PBD.

Finally, the services have one last chance to challenge a *signed* PBD reduction. If the respective service chief believes that the PBD is serious enough, he/she may initiate the Major Budget Issue (MBI) Process. This process triggers a meeting between the service secretary and the SECDEF to discuss and resolve the disagreement.

### **C. PRESIDENTIAL BUDGET SUBMISSION**

The services adjust their BESs based on the results of the budget review process (PBDs and/or MBIs). OMB then compiles all portions of the federal budget for inclusion in the President's Budget. "Following a top line meeting with the President, the President's budget is finalized" and submitted to Congress. (Zimmer, 1996)

In reality, presidential and/or SECDEF influence has been present throughout the BES review process. This influence occurs via the DoD Comptroller who is primarily responsible to the SECDEF for the budgeting process and draws on other organizations within OSD to keep abreast of key

budgetary issues within the Department and the services. In addition, OMB staff members work directly at the Pentagon and participate in the budget review. "The defense budget is unique in the extent to which OMB is directly involved throughout the budgeting process." (Tyszkiewicz and Daggett, 1998, p. 28) This helps ensure White House influence and information flow throughout the process.

#### **D. THE CONGRESSIONAL ENACTMENT PROCESS**

The congressional enactment process consists of three main phases: (1) budget resolution, (2) authorization, and (3) appropriation (Phases 2 and 3 occur more or less concurrently).

##### **1. The Budget Resolution**

The budget resolution process was established as part of the Congressional Budget Control and Impoundment Act of 1974. "The process is centered around an annual concurrent resolution on the budget that sets aggregate budget policies and functional priorities for a multiyear period. (Keith, 1997) The budget resolution process represents a key procedural reform Congress enacted to improve the budget process. The resolution process affords Congress the opportunity to internally address and achieve broad budget-related goals by establishing revenue and spending limits and facilitating enforcement of those limits through points of order. (Keith, 1997)

To this end, the '74 Act established the House and Senate Budget Committees and assigned them various enforcement responsibilities within the

resolution process. First, the committees are responsible for drafting their respective concurrent budget resolutions that set and allocate ceilings within which authorization and appropriation committees work. The Budget Committees are ultimately responsible for making these allocations; however, the amounts represent the culmination of a collaborative process involving all the committees affected. Thus, the final allocations “are based on assumptions and understandings developed in the course of formulating the budget resolution.” (Keith, 1997)

Second, the '74 Act designates the House and Senate Budget Committees as the “principle scorekeeper for Congress.” (Keith, 1997) “Scoring” is the process of analyzing and measuring the budgetary impact of policy and legislation. The scoring process works to inform Members whether action being considered will potentially break budget levels agreed to in the budget resolution or committee sub-allocations. CBO analysts assist the Budget Committee chairmen in accomplishing their respective scorekeeping responsibilities. (Keith, 1997)

Finally, the '74 Act “provides for both substantive and procedural points of order to block violations of budget resolution policies and congressional budget procedures. (Keith, 1997) In this way, the Budget Committee chairmen use House/Senate rules to help enforce budget policy set during the resolution process. Typically, when a revenue or spending measure is brought to the floor, the respective Budget Committee chairman will advise the chamber if the pending legislation violates any points of order. The House or Senate will only consider

the legislation if no points of order are made or the points of order are waived. The House normally waives points of order by enacting a special rule. The Senate requires either unanimous consent or a motion, approved by a three-fifths vote, in order to waive points of order. (Keith, 1997)

Political and fiscal pressures, i.e., varying presidential and congressional priorities, deficit reduction or surplus enhancement, revenue and entitlement issues, etc., make the budget resolution process a key element toward enabling budgetary control within the U.S. Government. Significant changes to the President's budget are often proposed and enacted as part of this highly interactive and political process.

## **2. The Authorization Process**

The second phase of the enactment process is the authorization process. House and Senate rules establish the authorization committees. Their purpose is to set policy and establish governmental programs. The key authorization committees concerned with defense issues are the House Armed Services Committee (HASC) and the Senate Armed Services Committee (SASC). As a means of management control, HASC and SASC hearings begin after the President's State of the Union message. Hearings at all management levels go on for several months analyzing all aspects of DoD's portion of the budget submission.

### **3. The Appropriations Process**

The appropriations process represents the final stage of the congressional enactment process. The 13 annual appropriation bills, developed by the House and Senate Appropriation Committees, provide the budget authority required to operate the government. Hearings for the appropriations process are conducted in a manner similar to the authorization process.

### **4. The Congressional Appeals Process**

In addition to direct hearings, an informal congressional appeals process is conducted concurrently with all three phases of the enactment process and is available for executive branch and DoD officials to voice concerns regarding congressional action. Appeal materials generally consist of letters sent to committee chairmen that outline the department's view on a program, policy, or issue impacted by congressional action.

The final step in the enactment process occurs when Congress forwards proposed authorization and appropriation legislation to the President for signature. The president can either sign or veto any one of the proposed bills. A Presidential veto requires a two-thirds majority of Congress to override and pass the legislation. Assuming the President signs the legislation, the bill becomes law and the execution phase begins.



## E. BUDGET AUTHORITY (BA) VS. OUTLAYS

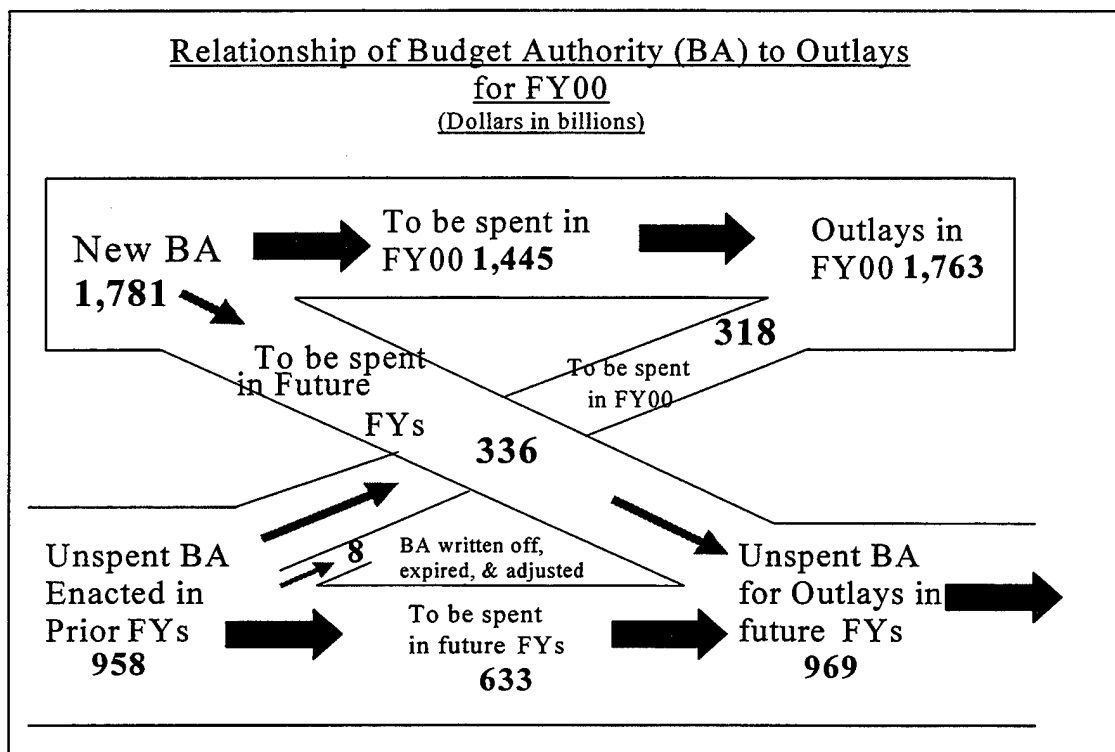
Through the congressional enactment process, Congress provides the DoD annual BA by appropriating funds via annual appropriation acts, primarily the Department of Defense and Military Construction Appropriation Acts. The Department of Defense Appropriation Act is further divided into functional appropriation titles to include, Military Personnel; Operations and Maintenance (O&M); Procurement; Research, Development, Test, and Evaluation (RDT&E); and Revolving and Management Funds. (Tyszkiewicz and Daggett, 1998, pp. 15-16) BA allows commands and agencies to enter into contractual *obligations* for the procurement of goods and services. “*Obligations* are incurred by signing contracts, placing orders, hiring personnel, making loans or grants, or the like. (See 31 USC 1501)” (Tyszkiewicz and Daggett, 1998, p. 5) In contrast, “outlays represent the *actual expenditure* of funds in payment of goods and services, usually in the form of a disbursement of cash, a check, or an electronic fund transfer.”<sup>3</sup> (Tyszkiewicz and Daggett, 1998, p. 5) Thus, outlays occur *only* when dollars are actually drawn from the U.S. Treasury.

Some appropriations draw actual dollars from the Treasury much more slowly than other appropriations. For example, procurement contracts may be paid over several years while a high percentage of O&M and personnel

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<sup>3</sup> “The phrase *defense budget* usually refers to budget authority for defense programs, while *defense spending* usually refers to outlays for defense programs. The distinction is not always made, however.” (Tyszkiewicz and Daggett, 1998, p. 5)

expenditures will be paid in the first year of the congressional appropriated BA. As this analysis will reveal, understanding the expenditure characteristics of the BA level approved via the budget process is critical to determining the outlays that will eventually materialize. Outlays in any given year result from both that year's new BA and BA provided in previous years. Figure 2.1 provides an illustration of the relationship between BA *approval* and actual outlay *spending* for the entire federal budget, using fiscal year 2000 budget data.



Source: (Analytical Perspectives, 1999).

**Figure 2.1. Relationship of Budget Authority (BA) to Outlays for FY00 (Dollars in Billions)**

Forecasting annual outlay spending levels is difficult because of varying spending rates (within and across appropriations), the impacts from continual executive branch and congressional policy changes, and the overall procedural complexity of the process. As a consequence, “outlays in any given year, resulting from new BA and from BA provided in prior years, must be estimated based on historical experience.” (Daggett, October 1998) As a result, CBO and OMB-DoD analysts often disagree when estimating the outlays associated with the administration’s budget requests.

### **III. FY99 OUTLAY ESTIMATION SUMMARY DATA**

#### **A. INTRODUCTION**

My analysis of the FY99 outlay estimate problem begins by isolating the account-level differences between CBO and OMB-DoD outlay estimates. My intent is to highlight those accounts in which the outlay problem appears to be most severe. In addition, I will provide a brief explanation of each account since the execution characteristics of each may contribute to the outlay estimate problem.

#### **B. SIZE OF THE OVERALL FY99 OUTLAY ESTIMATE PROBLEM AND ACCOUNT-LEVEL BREAKDOWN**

As illustrated in Figure 2.1 (Chapter II), outlays in any given year result from both the new BA provided for that year and previously appropriated BA. Thus, the difference in CBO and OMB-DoD FY99 outlay estimates results from estimates of the outlays associated with the FY99 BA and outlays for FY99 from previously appropriated BA.

Summarizing their FY99 outlay estimate discrepancies, the directors of CBO and OMB indicated that:

*CBO estimates that discretionary outlays for defense in fiscal year 1999 will be \$3.7 billion higher than OMB estimates, assuming enactment of the Administration's budgetary proposals. Of that difference, \$1.5 billion results from differing outlay rates and \$2.2 billion results from disagreements about prior year outlays. (Raines and O'Neill, 1998)*

The \$3.7B outlay estimate difference cited by CBO and OMB included the entire national defense budget function (050). Budget function 050 “encompasses not only DoD programs but a number of defense-related activities administered by other federal agencies.” (Tyszkiewicz and Daggett, 1998, pp. 2-3) Budget function 050 is divided into three sub-functions including: (1) sub-function 051, Department of Defense - Military; (2) sub-function 053, Atomic energy defense activities; and (3) sub-function 054 Defense related activities.<sup>4</sup> For purposes of my analysis, I will focus on those accounts within budget sub-function 051.

The vast majority of the \$3.7B discrepancy (\$3.582B) falls within budget sub-function 051. In addition, limiting the analysis to budget sub-function 051 is consistent with the overall thesis objective of determining the primary causal factors contributing to the outlay estimate differences between CBO and OMB-DoD associated with DoD’s FY99 budget estimate submission.

Over 90 percent of the \$3.582 billion outlay estimate discrepancy occurs within ten budget sub-function 051 accounts. Table 3.1 summarizes the CBO/OMB-DoD outlay discrepancies within these ten account areas and illustrates the relative size each 051 account contributed to the total discrepancy.

It also indicates how much of the difference is associated with estimates of outlays from new BA and from previously appropriated BA. A preponderance of

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<sup>4</sup> “What was formerly sub-function 052 (Foreign Military Sales) was transferred to Function 150 (International Affairs) in 1978.” (Tyszkiewicz and Daggett, 1998, p. 16)

**Table 3.1. Summary Chart of CBO/OMB (DoD) FY99 Outlay Estimate Differences (in millions)**

SUMMARY CHART OF CBO / OMB(DoD) FY99 OUTLAY ESTIMATE DIFFERENCES					
(in millions)					
(negative dollars reflect CBO outlay estimates < OMB)					
ACCOUNT AREA	Due to new (FY99) BA	Due to prior FY BA	Total Difference	% of Total	% of Total (Combined O&M)
WCfs	253	1,111	1,364	38.08%	11.95%
RDT&E, AF (note 1)	380	287	667	18.62%	
O&M, AF (note 2)	(153)	350	197	5.50%	
O&M, ARMY	294	(176)	118	3.29%	
O&M, NAVY	(66)	179	113	3.15%	
SCN (note 3)	20	220	240	6.70%	
OP, AF (note 4)	220	(54)	166	4.63%	
APN (note 5)	67	100	167	4.66%	
BRAC (note 6)	128	(3)	125	3.49%	
Former Soviet Union	-	109	109	3.04%	11.95%
Other (note 7)	311	5	316	8.82%	
TOTAL	1,454	2,128	3,582	100%	
note 1: Research Development Test & Evaluation, Air Force					
note 2: Operations & Maintenance, Air Force		note 5: Aircraft Procurement, Navy			
note 3: Shipbuilding & Conversion, Navy		note 6: Base Realignment & Closure			
note 4: Other Procurement, Air Force		note 7: Net difference of approx 100 accounts			

Source: (Raines and O'Neill, 1998; DoD Spring 1998).

the outlay estimate problem (over 75 percent) is associated with four specific account areas: (1) WCF 38.08 percent, (2) RDT&E, AF 18.62 percent, (3) the O&M accounts 11.95 percent, and (4) SCN 6.7 percent.

A second way to analyze the data is to measure the size of the estimate difference relative to the total BA within each account area. Table 3.2 provides this data comparison for the four specific account areas mentioned above.

As illustrated in Table 3.2, the outlay estimate differences represented relatively small percentages of each of their respective accounts. In addition, the small and somewhat similar percentage levels illustrate relative consistency across accounts regarding outlay estimating difficulty. A large percentage spike in any

one account might reveal estimating difficulty within that account since relative size was considered in the analysis. This type of analysis could be important in identifying outlay estimating trends and/or difficulties within specific accounts.

**Table 3.2. FY99 Outlay Estimate Differences as a Percent of Total BA (in millions)**

FY99 OUTLAY ESTIMATE DIFFERENCES AS A PERCENT OF TOTAL BA (in millions)				
ACCOUNT AREA	Total Difference	Total BA	% of Total	% of Total (Combined O&M)
WCFs	1,364	61,000	2.24%	0.73%
RDT&E, AF (note 1)	667	13,598	4.91%	
O&M, AF (note 2)	197	19,177	1.03%	
O&M, ARMY	118	17,273	0.68%	
O&M, NAVY	113	21,927	0.52%	
SCN (note 3)	240	6,253	3.84%	
note 1: Research Development Test & Evaluation, Air Force note 2: Operations & Maintenance, Air Force note 3: Shipbuilding & Conversion, Navy				

Source: (DoD, December 1998; OSD Compt).

However, the primary concern from the perspective of the Budget Committees and CBO is the actual dollar amount of the respective estimate differences. In fact, it's the total estimate difference that fuels the problem and becomes the focus of the solution – not how big the problem is relative to BA totals.

The four accounts highlighted above represent the key area of concern regarding the FY99 outlay estimate problem. Given the relative weight, in terms of dollar value, of their contribution to the outlay problem, these four areas will be

the focus of this thesis. The remainder of this chapter provides a preliminary description of the execution characteristics of these four account areas.

### **C. WORKING CAPITAL FUNDS (WCFS)**

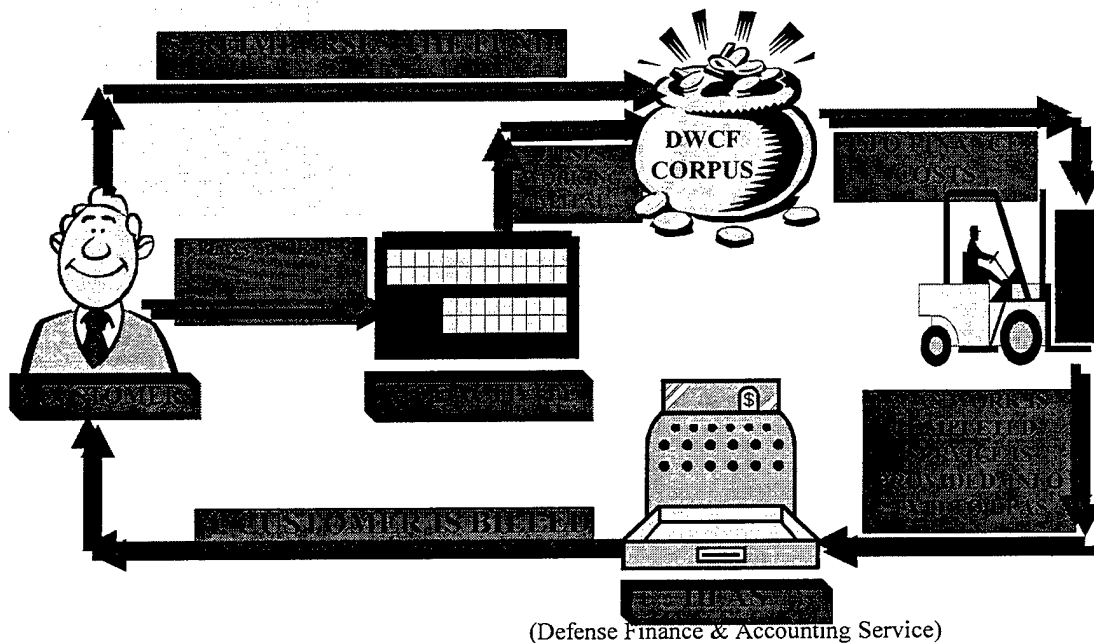
WCFs consist primarily of stock funds or industrial funds. Stock funds support supply-related activities, to include “clothing, medical supplies, fuel, construction supplies, ordinance repair parts, consumable aircraft and missile parts, tank and automotive supplies, and general retail supplies.” (Tyszkiewicz and Daggett, 1998, p. 16) Industrial funds support primarily logistics and maintenance related activities to include equipment overhauls and transportation services. (Tyszkiewicz and Daggett, 1998, p. 16)

DoD WCF activities operate under a revolving fund concept. In a sense, these activities operate much the same as any retail/wholesale enterprise by using their receipts to pay operating expenses and purchase new stock. However, their primary customers comprise other DoD activities and organizations. Thus, government funds flow into these activities from a variety of sources/accounts and are not actually disbursed until the WCF activity pays operating expenses or buys additional inventory. Figure 3.1 illustrates the typical operation and funding flow for a WCF activity:

As Figure 3.1 illustrates, Congress appropriates a one-time cash “corpus” (a principle or capital sum) to initiate the fund and provide financing for WCF operations and inventory. DoD WCF customers receive, via their respective



## WCF - A Revolving Fund



Source: (PCC Companion Guide, 1998).

**Figure 3.1. WCF – A Revolving Fund**

funding chains, annual BA appropriated by Congress, and use this BA to purchase goods and services from WCF activities. WCF activities, in turn, use the receipts from DoD customers to reimburse the corpus and further finance operations and inventory. (Tyszkiewicz and Daggett, 1998, p. 16) As we will discuss in Chapters IV and V, this complex funding flow significantly impacts the outlay estimating process.

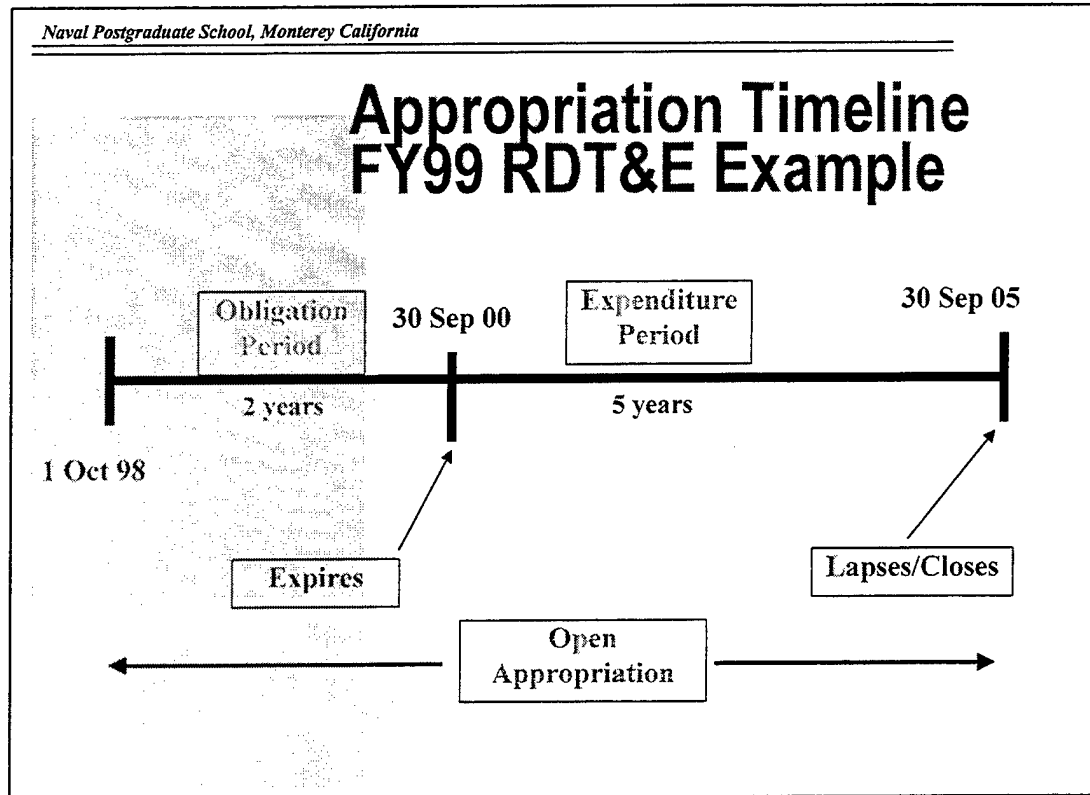
As a result of the wide variety of products and services purchased via DoD's WCFs, several different accounts and spend-out rates can apply to WCF

fund execution. In general, the DoD's WCFs execute O&M dollars and therefore, WCF outlays are most heavily influenced by O&M spend-out rates. However, WCF spend-out rates are also influenced by the execution characteristics of the RDT&E and procurement accounts, since these funds are also received and disbursed by WCF activities. (PCC Companion Guide, 1998) The execution characteristics of all three of these accounts are addressed below.

#### **D. RDT&E**

RDT&E accounts include "development and testing of weapons and equipment, development of prototypes, fabrication of technology-demonstration devices, and support of basic research and exploratory development of technologies with potential military applications." (Tyszkiewicz and Daggett, 1998, p. 16) Specific analysis of RDT&E, AF spend-out rates is less complex than analysis of WCF rates, since the account is funded within a single appropriation title (RDT&E). The RDT&E appropriation provides multi-year BA that retains its obligational authority for two years and its expenditure authority for an additional five years. Figure 3.2 displays the appropriation timeline for the RDT&E obligation and expenditure time periods.

As indicated in Chapter II, Section E, the *obligation* period represents the timeframe in which commands and agencies can use new BA to enter into contractual obligations for the procurement of goods and services. In addition, legitimate adjustments to these obligations can be made throughout the seven year



Source: (PCC Companion Guide, 1998).

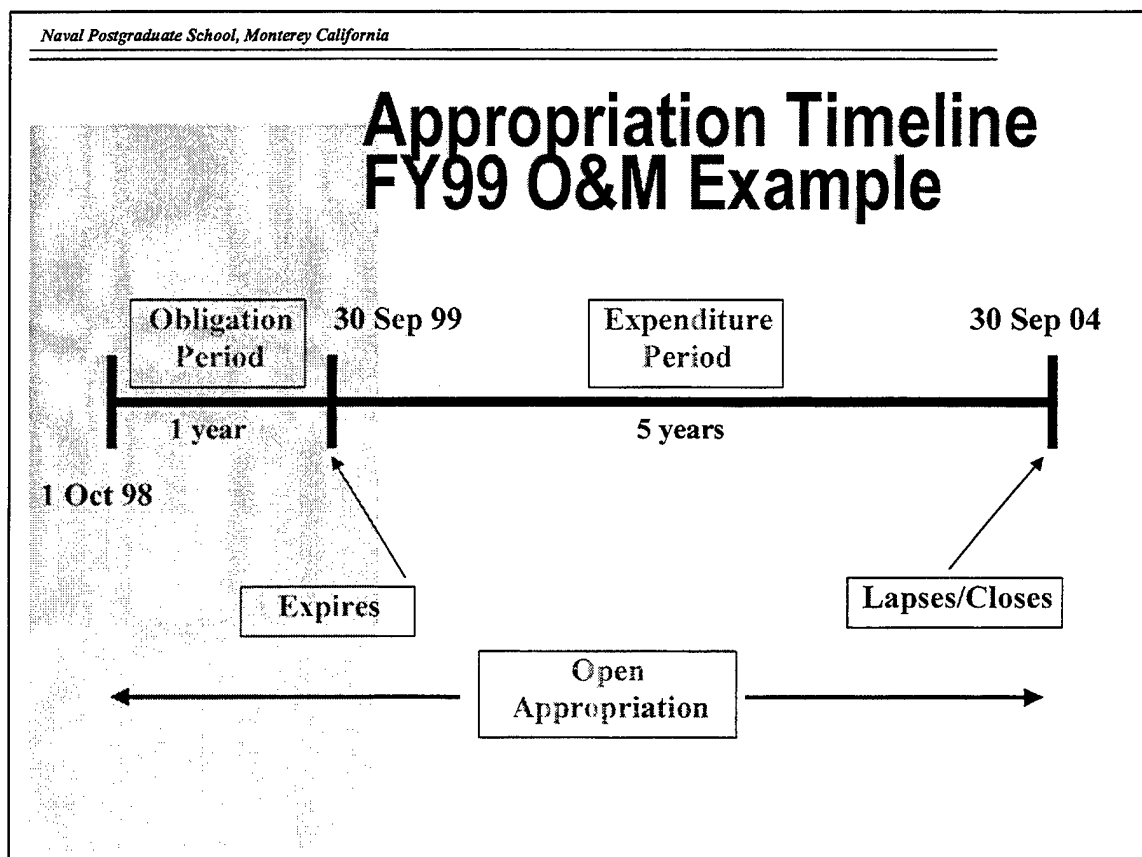
**Figure 3.2. Appropriation Timeline FY99 RDT&E Example**

period. Actual expenditure of funds related to these obligational contracts and adjustments can, by law, occur throughout the obligational and expenditure periods. It is this actual expenditure rate that is most relevant to estimating outlays within a particular account/appropriation.

### **E. O&M ACCOUNTS**

Although the April 98 CBO/OMB joint memo, summarized in Table 3.1, lists three separate O&M accounts, I have grouped them together because they all display similar execution characteristics. O&M is an annual appropriation, funding day-to-day operational requirements within the services. These include

aircraft “flying hours, ship operations, training for land forces, individual training and exercises, real property maintenance and minor construction projects, the purchase of fuel, repair parts, supplies, minor items of repair equipment, and various personnel, base operating, and administrative support activities.” (Tyszkiewicz and Daggett, 1998, p. 15) The obligation and expenditure timeline for O&M accounts is illustrated in Figure 3.3.

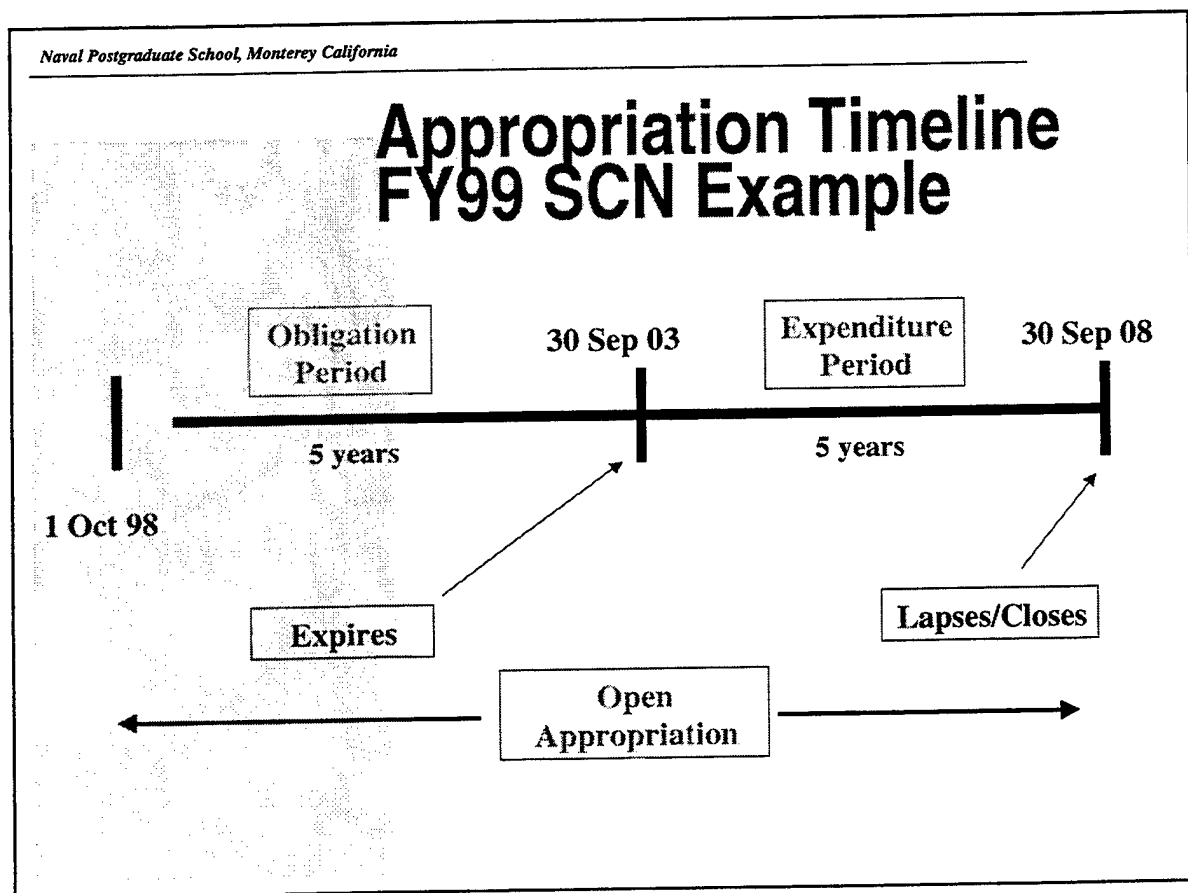


Source: (PCC Companion Guide, 1998).

**Figure 3.3. Appropriation Timeline FY99 O&M Example**

## F. SHIPBUILDING AND CONVERSION, NAVY (SCN)

The SCN account is funded within the procurement appropriation. In general, the SCN account “finances the construction of new ships and conversion of existing ships, including all hull, mechanical and electrical equipment, electronics, guns, torpedo and missile launching systems, and communication systems.” (NavCompt Manual, 1990) SCN within the procurement appropriation is a multi-year account. Its typical obligation and expenditure timeline is illustrated in Figure 3.4.



Source: (PCC Companion Guide, 1998).

**Figure 3.4. Appropriation Timeline FY99 SCN Example**

Subsequent chapters will reveal that the WCF, RDT&E, and O&M accounts represent BA levels that spend-out relatively quickly, i.e., most expenditures occur within the first two years of BA approval. Unlike these quick-spending accounts, procurement funds, e.g., SCN, typically spend-out at a much slower rate. The spend-out rate estimated for SCN is illustrated below, using the average of the estimates provided by CBO and OMB:

<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
5.1%	21.3%	22.9%	21.0%	10.2%

As these rates indicate, outlay levels in the SCN account are most heavily influenced by prior year vice new BA funding levels. This result is typical of all DoD procurement accounts, given the way Congress funds long-term/high-priced programs. Congress' full-funding policy requires, with limited exceptions, that "agencies must request an amount to be appropriated in the first year that they estimate will be adequate to complete an economically useful segment of a procurement or project, even though it may be obligated over several years." (Analytical Perspectives, 1999) The intent of this policy is to ensure that decision-makers take into account the total costs and benefits associated with a program prior to approving resources. As a result of this policy, annual SCN BA levels will often take several years to be fully executed/disbursed. Thus, outlays

associated with annual BA levels will occur for several years as contracts are awarded, ships are built, and delivery of final end-items are received.

#### IV. PROCESS FACTORS ASSOCIATED WITH THE FY99 OUTLAY ESTIMATE PROBLEM

##### A. INTRODUCTION

In Setting National Priorities – Budget Choices for the Next Century, Robert Reischauer described the “symbolic” political role budget deficits have played over the last 20 years:

*Since the early 1980s, the deficit has become more than just another problem to manage or try to solve. Deficits have become symbols.... In short, many important but divisive questions involving the philosophy of government have merged into the debate over the deficit. (Reischauer, 1997)*

A key legislative outcome of these deficit-driven debates has been the budget process reforms described in Chapter I. Of particular relevance to this study are the discretionary spending reforms, i.e., discretionary caps, for both the outlay estimation debate and ultimate deficit reduction.

As such, accurate outlay estimates become an increasingly important element for budget process reforms in two areas. First, outlay projections are used to establish benchmarks from which current and future policy objectives are formulated and debated. Based on their January 1999 outlay projections, CBO forecast federal budget surpluses for the next several years. (CBO, 1999, p. 1) As a consequence, both political parties formulated policy objectives and determined the affordability of those objectives based on the size of these surplus projections.



Second, the ultimate accuracy of the outlay estimates and the policies they enable, or limit, will directly contribute to our ability to control deficits in the future.

Given the significant political and practical role of outlay estimates, it's important to understand the process by which outlay projections are determined. In Chapter III, I showed that CBO and OMB-DoD had disagreed in the spring of 1998 concerning their FY99 outlay estimates. Additionally, I highlighted the four account areas where their outlay estimate discrepancies were most severe. In this chapter, I focus on the outlay estimating process and the specific CBO and OMB-DoD methods that drove each of their FY99 forecasts.

I begin by summarizing the overall outlay estimating process and the important budgetary factors that influence that process. This summary is helpful in establishing an understanding of the complex environment within which both CBO and OMB-DoD analysts formulate their estimates. Next, I compare and contrast the methods CBO and OMB-DoD used to formulate their specific FY99 outlay estimates. Finally, I outline the specific assumptions and analysis used by CBO and OMB-DoD in formulating their FY99 outlay estimates. These final two sections help focus the discussion on the specific problems that led to the FY99 outlay estimate discrepancy.

## **B. THE OUTLAY ESTIMATING PROCESS**

In concert with congressional budget reforms, i.e., spending control legislation and procedures, the CBO and OMB-DoD are required to estimate the

budgetary impact of budget requests and appropriation bills throughout the budget estimate submission (BES) and legislative processes. The ability of analysts to accurately estimate outlays is heavily influenced by both the complexities of the process itself and analysts' ability to formulate realistic BA spend-out rates within each 050 account.

### **1. The Variability and Complexity of the Outlay Estimating Process**

In an attempt to improve the outlay estimating process, legislation was passed in the late 1980s requiring CBO and OMB to issue a joint report designed to project both outlay rates and the influence of prior-year BA levels on the upcoming budget cycle. "The clear purpose of the law is to minimize differences between CBO's and OMB's estimates." (Aycock and Fontaine, 1998, p. 7) Despite this legislation, outlay estimate differences between CBO and OMB have persisted.

Failure of the CBO and OMB-DoD to accomplish the purpose of the legislation reflects the inherent complexity of the analysis vice some other bureaucratic inefficiency. The overall variability of the DoD's many programs coupled with the impact that variability has on spending rates can easily explain why two competent analysts could arrive at two different outlay estimate conclusions. (Aycock and Fontaine, 1998, pp. 7-14) Several inherent problems and complexities within the outlay estimating process are summarized as follows:

a. "Outlay caps in the Balanced Budget Agreement (BBA) have been more constraining than the limits on BA." (Aycock and Fontaine, 1998, p. 7) This situation could conceivably influence the DoD to project lower, "more optimistic," outlay estimates since lower estimates would increase the chances of obtaining the requested BA levels.

b. Outlay estimates must be projected 7-10 months before the budget year begins. That means that the most recent annual data for each account is two years old before the budget year. For example, to develop the FY99 outlay estimates, analysts had only FY97 actual execution data. Considerable uncertainty about how a program may change during FY98 and FY99 must be extrapolated. Given the variability in program execution, this represents a very complex extrapolation and raises significant issues that must be resolved between CBO and OMB-DoD analysts. The unpredictable time length associated with key policy decisions or the variability of a contractor's work schedule are just two examples of key execution issues greatly impacting outlay estimates. Unless analysts can reach timely concurrence on such issues, different outlay estimates will continue to pass to the congressional committees for final resolution. (Aycock and Fontaine, 1998, pp. 12-13)

c. Legislative transfer authority complicates analyzing outlay estimates for individual DoD accounts. Legislative transfer authority allows agencies to move a limited amount of funds between accounts in recognition of

program variability and the need for efficient execution. Within DoD, legislative transfer authority ranges between \$1.5 and \$2.5 billion. Keeping track of the amount and timing of this transfer authority can greatly complicate current and future outlay estimates. (Aycock and Fontaine, 1998, pp. 13-14)

d. Finally, the complexity and interactions that characterize the WCF make outlay estimation within this account very difficult to forecast, especially as it relates to the timing of the actual disbursement/outlay. The WCF buys a wide variety of goods and services from private sector suppliers with revenues obtained from sales to other DoD customers. Consequently, a net outlay only occurs when funds are actually spent from the WCF, i.e., to replenish stock, pay salaries, make capital investments, etc. Management policy and execution alternatives within the DoD and the WCF will greatly influence when a "net outlay" occurs. This policy and execution area within DoD is particularly variable given the impact of changing customer demand and the wide variety of goods and services being procured via the WCF. (Aycock and Fontaine, 1998, p. 14)

## **2. Spend-Out Rates**

Spend-out rates reflect how quickly BA is converted from spending authority to actual disbursement of funds from the U.S. Treasury. These rates are typically summarized as a percentage that indicates the amount of new BA expected to be disbursed in the first year the funds are authorized and each subsequent year thereafter. Accounts that support routine DoD operating

expenses, research, and salaries are disbursed relatively quickly, while long-term construction or procurement programs will typically take several years to be fully disbursed. "For example, an account that consists largely of personnel costs might have a spend-out rate of 90 percent in the first year and 10 percent in the second year. In contrast, appropriations for a construction account might be disbursed over a four-year period – for example, at a rate of 20 percent the first year, 40 percent the second year, 30 percent the third year, and 10 percent the fourth year." (Aycock and Fontaine, 1998, p. 3)

As a result, these variations in spend-out rates largely determine the impact BA levels will have on the timing of outlays. High first-year spend-out rate accounts will be influenced primarily by the amount of BA authorized for that particular year. Conversely, outlays for low first-year spend-out rate accounts will be most heavily influenced by BA levels authorized in prior years. We can also conclude that spend-out characteristics are driven primarily by the type of account being funded. As such, an important element of the outlay estimate process is to determine/estimate each account's unique spend-out rate. (Aycock and Fontaine, 1998, pp. 3-4)

In Chapter III, I highlighted four account areas that represented over 75 percent of the CBO/OMB-DoD FY99 outlay estimate discrepancy – WCFs (which reflect primarily O&M spending characteristics); RDT&E; O&M; and SCN. Each budget cycle, the DoD publishes their budget guidance which estimates the

incremental outlay rates by 051 account that commands and agencies should use as a guideline to analyze and estimate the budgetary impact of new BA request levels. Table 4.1 summarizes these rates for the FY99 budget cycle in the accounts that comprised the predominant portion, in terms of total dollar level, of the FY99 outlay discrepancy.

**Table 4.1. Outlay Rates to be Used for Incremental Changes in BA Purchases (as Percent of BA Purchases)**

<b>Outlay Rates to be Used for Incremental Changes in BA Purchases</b> (as Percent of BA Purchases)							
<b>Appropriation</b>	<b>1st Year</b>	<b>2d Year</b>	<b>3d year</b>	<b>4th Year</b>	<b>5th Year</b>	<b>6th Year</b>	<b>7th Year</b>
RDT&E, AF	42.04%	42.43%	9.46%	6.07%			
O&M, AF	40.18%	46.66%	7.18%	5.98%			
O&M, A	42.47%	45.65%	7.69%	4.19%			
O&M, N	60.07%	34.12%	3.69%	2.12%			
SCN	4.90%	17.20%	22.20%	19.50%	13.80%	11.20%	11.20%

Source: (DoD, Outlay Rates, FY99).

DoD does not publish WCF rates as part of their budget guidance. Rather, these rates are derived based on the type of WCF account, i.e., O&M, RDT&E, Procurement, etc., and the amount that is expected to pass through the fund in a given year. These rates are typically very high because DoD policy attempts to achieve a zero Net Operating Result (NOR) within the WCF account each fiscal year. In other words, they attempt to take in as much as they expect to spend. I discuss this policy and its impact on the FY99 outlay discrepancy later in this chapter (DoD, Outlay Rates, FY99; DoD, Spring 1998, p. 10).

I have two purposes for including the rates in Table 4.1. First, displaying these rates provides a general indication of how they are reflected in DoD budgetary guidance. This helps clarify the previous discussion of spend-out rates and their influence within the outlay estimating process. Second, it indicates the typical spend-out rate characteristics for those account areas that were the primary area of disagreement between CBO and OMB-DoD in FY99. While these "incremental" rates are different than the aggregate rates that consider prior-year BA influences, they do illustrate the relative spend-out "speed" between the accounts. The primary area where CBO and OMB-DoD disagreed regarding FY99 outlay estimates occurred in the relatively quick-spending accounts, i.e., WCF, O&M and RDT&E. The WCF discussion above and Tables 3.1 and 4.1 support this assertion.

### **C. THE CBO AND OMB-DOD OUTLAY ESTIMATING METHODS**

Account-level spend-out rates reflect the foundation of both CBO's and OMB-DoD's outlay estimating methodology. In "An Analysis of CBO's Outlay Estimates for Appropriation Bills, Fiscal Years 1993-1997," Aycock and Fontaine summarized the basic methodology CBO uses to estimate outlays:

*CBO estimates spend-out rates and prior-year outlays by analyzing the historical track record for each account. Because the relationships between budget authority and outlays are generally not constant from year to year, CBO reviews the actual results each year so that its estimates reflect the most recent experience. CBO begins the process when it prepares its preliminary baseline projections in December of each year and refines the estimates after it receives the Administration's budget in February. The projected*

*spend-out rates and prior-year outlays are used in CBO's analysis of the Administration's budget request and are usually reflected in the estimates underlying the budget resolution adopted by the Congress. (Aycock & Fontaine, 1998, p. 4)*

In a spring 1998 briefing on the FY99 outlay estimate differences, DoD analysts summarized their basic outlay estimating method as follows:

*DoD-OMB makes a forward looking projection based on program content (e.g., major new acquisition programs such as F-22, CVN, and new procurement versus modification), the inter-relationships between various accounts (e.g., such as O&M, WCF and advanced billings), program execution experience, and changes to the administration's original budget request. DoD-OMB adjusts to trends that emerge from historical execution experience. Since trends, in the short term, are difficult to identify and distinguish from what may be a one time aberration, DoD-OMB estimates tend to be derived by identifying a mid-point range using both trend and average analysis techniques. This avoids placing too much weight on a single year's worth of execution data. (DoD, Spring 1998, p. 2)*

Although the two basic methods are somewhat similar, i.e., an emphasis on execution performance, changing historical trends, and future program/policy analysis and adjustments, the differences in outlay estimates between CBO and OMB-DoD analysts are a recurring theme.

Two overriding procedural issues contribute to this recurring outlay estimate problem: (1) ineffective implementation by CBO and OMB of congressional guidance, and (2) failure by CBO and OMB to effectively document outlay estimating procedures.



## **1. Ineffective Implementation of Congressional Guidance**

As previously mentioned, legislation was passed in the late 1980s requiring CBO and OMB to work together and issue a joint report designed to minimize outlay differences prior to budget submission. Unfortunately, it appears that this report, based on its current preparation timeline and content, can only serve as a mechanism for identifying areas of outlay estimate disagreement.

Two examples illustrate this assertion. First, the CBO/OMB FY99 joint report was not completed in time to serve as a viable FY99 budgetary planning document. The law requires that the joint report be completed by December 15<sup>th</sup> of each year. If complied with, this date would provide OMB and DoD analysts the time to adjust their BES to reflect areas of outlay consensus reached during the preparation and submission of the report. Language from the Senate's FY99 Concurrent Budget Resolution reflected the Senate Budget Committee's frustration regarding the apparent disregard of the letter and intent of the statute.

*Title 10 U.S.C 226 requires an annual CBO/OMB report to the House and Senate Budget Committees, among others, not later than December 15 of each year. The report is intended to identify the outlay rates and other technical assumptions used in preparing budget estimates. No such letter has been submitted for the 1999 budget as of the date of this resolution. The failure of OMB to conform to more historically accurate outlay rates and the tardy preparation of this letter has seriously complicated the Committee's work. The Committee urges that the statutory requirement for this letter be observed. (U.S. Senate, April 1998 , p. 15)*

Obviously by 20 March, the ability to use this reporting process to minimize CBO and OMB outlay discrepancies prior to budget submission had long since passed.

This trend continued with the formulation of the FY00 budget. In an 8 February email, an OMB outlay analyst responded to my questions concerning the FY00 outlay estimating process as follows: "I cannot share with you much of FY2000 as it is still in the making. I have just completed drafting the joint letter and it's beginning its long journey of coordination before our Director and CBO Director sign it." (Gallo, February 1999) It's clear from both these comments and the OMB/CBO preparation timeline that the intent of the joint report, "to identify the outlay rates and other technical assumptions used in preparing the budget estimates", is not being accomplished. (U.S. Senate, April 1998, p. 15) As summarized in CBO's stated outlay-estimating method, they don't even begin their "preliminary" baseline projections until December, and only refine their estimates after they receive the Administration's budget in February. This timeline is clearly at odds with "resolving/minimizing" outlay estimate differences prior to the Administration's BES.

A second example of ineffective implementation of congressional guidance on joint CBO/OMB outlay estimation is the fact that the content of the joint letter simply lists account areas, spend-out rates, and prior-year outlays where the two parties agree and disagree. While the report may be a useful mechanism to ensure that both sides are engaged in the problem, the overall intent of the joint report is

not achieved since budgets are ultimately formulated and submitted without resolution of the key technical and policy assumptions used to drive spend-out rates and prior-year outlays. Consequently, failure to achieve the procedural intent of the letter shifts the debate to Congress and seriously complicates the work of congressional committees.

## **2. Need for a Documented Outlay Estimating Method**

It's difficult to define with great precision the specific methods used by both CBO and OMB-DoD in arriving at their respective FY99 outlay estimates. A clearly defined and documented outlay estimating process or procedure does not exist within either CBO or OMB-DoD. Comments by an OMB outlay analyst support this fact: "How we estimate rates at OMB/DoD is an acquired skill with no written budget guidance. One person did it for years, my predecessor did it for two years, this is my second year, we learn from each other." (Gallo, February 1999) I received similar comments from a CBO outlay analyst, in a phone conversation on 5 February 1999. (Christensen, February 1999)

The lack of a consistent and documented method for estimating outlays within these two organizations further complicates this already difficult process. A documented method could not resolve all estimate differences, especially those driven by policy changes and their potential impact on future spend-out rates. However, a basic method could establish similar statistical approaches and provide a consistency to initial outlay estimates. For example, mathematical trend analysis

parameters could be established for each account, i.e., a moving average of specified length based on execution actuals. Specifying these parameters would clearly establish the "initial outlay estimate" for a given level of BA. The method/process could then allow for policy arguments and focused debate when either agency wants to deviate from these "initial outlay estimates."

Without an initial starting point for outlay estimates and/or documented procedures for establishing deviations from historical trend analysis, the chances increase that significant outlay estimate discrepancies between CBO and OMB-DoD will materialize. This fact, coupled with the timeline problems addressed earlier, help explain the procedural difficulty CBO and OMB-DoD analysts have faced in agreeing on outlay estimates prior to budget estimate submissions.

#### **D. CBO AND OMB-DoD FY99 OUTLAY ESTIMATE ASSUMPTIONS AND ANALYSIS**

The FY99 outlay estimate discrepancy and debate reached its climax as the congressional Budget Committees began their work. An OMB outlay analyst summed up the outcome of the FY99 outlay estimating process: "OMB defended its numbers to the budget committees and they directed CBO to use OMB rates." (Gallo, February 1999) Since OMB-DoD are required to defend their outlay estimate assumptions and analysis before the Budget Committees (and others), documentation on their position is more readily available. In a spring 1998 briefing, DoD justified their FY99 outlay estimates. Their arguments within each

of the four "problem" account areas (WCF; RDT&E, AF; O&M; and SCN) are summarized below.

# **1. WCF**

The WCF outlay discrepancy between CBO and OMB-DoD is primarily attributable "to CBO not recognizing a DoD policy decision to raise cash (non-outlay event) during FY99 in support of meeting the 7-10 days of (working) cash requirements for the Defense WCF." (DoD, Spring 1998, p. 9)

In theory, DoD attempts to achieve a zero NOR within the WCF account each fiscal year. They accomplish this goal by anticipating product and service demands and setting customer rates such that all costs incurred each fiscal year by the WCF activities are recovered within that same year.

Several factors impact DoD's ability to achieve their NOR goals. For example, operational contingencies may force a command or agency to cancel scheduled maintenance with a WCF activity. If the WCF activity is unable to fill the vacancy left by this cancellation, they experience idle capacity and a loss of expected revenue. Since customer rates are predetermined prior to the FY, the WCF activity is unable to fully cover their annual operating costs and they experience an operating loss. DoD WCF policy requires that operating losses in prior years be offset in subsequent years.

DoD's WCF losses totaled \$2.4 billion in FY 1997. (DoD, Spring 1998, p. 10) To address this operating loss, DoD proposed: (1) selling and not replacing

inventory (\$230M), (2) increasing prices and adding a surcharge for WCF customers to raise cash (\$1,092M), and (3) transferring cash from the stockpile account to the WCF (\$265M). DoD's intention was to use these additional funds to raise cash levels within the WCF corpus. As a result, the funds will not be available to cover FY99 operating expenses or to buy inventory. (DoD, Spring 1998, p. 10)

The sum effect of DoD's WCF policy represented a \$1,587M FY99 negative outlay estimate. DoD summarized their argument as follows: "CBO believes the WCF should be managed to break even and outlays should approach zero each year. This is correct when cash balances are adequate and there is no threat of insolvency. However, this is not the current situation and DoD must raise cash to ensure solvency of the fund." (DoD, Spring 1998, p. 10)

DoD claimed that CBO ignored the Department's attempt to build cash within the WCF. More likely, CBO was unaware of DoD plans until after the Budget was submitted and the joint report was prepared. Understandably, CBO's outlay estimate did not recognize the cash transfer from the stockpile account and estimated that the WCF would experience outlay levels much closer to the historical policy goal of a NOR equal to zero. Consequently, CBO estimated a negative outlay within the WCF of only \$223M. (DoD, Spring 1998, pp. 3, 9-10) (Raines and O'Neill, 1998, pp. 10, 15-16) The net effect from the different estimating assumptions used by CBO and OMB-DoD was a WCF outlay estimate

discrepancy of \$1,364M. (DoD, FY 1999 Defense Outlays, pp. 3, 9-10) (Raines and O'Neill, 1998, pp. 10, 15-16)

## 2. RDT&E, AF

The slide which presented DoD's justification of their RDT&E, AF outlay estimate is provided in Figure 4.1.

Appropriation: RDT&E, Air Force		<u>\$ In Millions</u>			
• Outlay difference		667			
• FY 1999 New BA (BA)/PY Available to Spend		21,411			
• Rate Comparison (first year)					
– CBO		53.5%			
– DoD		50.7%			
• Actual Experience					
		<u>FY 1994</u>	<u>FY 1995</u>	<u>FY 1996</u>	<u>FY 1997</u>
- RDT&E, AF first year %		44.3	47.2	46.7	57.9
• Analysis:					
- CBO's estimate places too much emphasis on one year's (FY97) experience. Last year DoD estimated first year RDT&E,AF outlays at 42.7%. DoD recognized the prior year trend experience and raised its estimate from 42.7% to 50.7%. This exceeds the four year (FYs 94-97) average of 49.0%.					
- DoD took into account the increasing trend observed from prior year actuals. As a result, DoD's estimate is greater than any of the years prior to FY 1997 and is approximately the mid point between the average of the FY94 through FY96 actuals and the FY97 actual.					

Source: (DoD, Spring 1998, p. 12).

**Figure 4.1. Appropriation: RDT&E, Air Force**

Figure 4.1 clearly illustrates that the RDT&E, AF argument centers on differences in historical trend analysis. DoD experienced an upward shift during FY97 in the spend-out rate for this account. They claim to have recognized this shift in their 50.7 percent estimate by using a mid-point estimating technique that

represents a value half-way between the FY94/95/96 average and the FY97 spend-out rate. (DoD, Spring 1998, p. 12) This gives them an estimate greater than any of the actual spend-out rates from FY94 through FY96.

CBO also argues that the upward trend will continue. However, they have attributed more relative weight to the FY97 actuals in arriving at their outlay estimate of 53.5 percent. CBO's method applies a rate that is slightly higher than the two-year average of FY96/97 actuals.

It's difficult to argue for one side or the other, but it's evident that a "standard method" for conducting historical trend analysis would be helpful. Without such a standard, the argument centers around whose method is more justified rather than why a shift from the "standard method" is warranted.

CBO's estimate is clearly more conservative, and history has shown in general that outlay estimates within BF 051 have been too low from both CBO and OMB-DoD. (Aycock & Fontaine, 1998, p. 7) Perhaps this gives credence to the argument that a more conservative approach would lead to more accurate estimates. In Chapter V, I discuss outlay estimate accuracy in greater detail, but the evidence is far from conclusive on this issue.

One final issue from the DoD argument is the rudimentary trend analysis procedures they use to justify their estimate. Using simple averages of recent execution statistics seems unsophisticated given the availability of more refined statistical and mathematical modeling techniques. For example, the availability



and characteristics of BA/outlay data seem ideally suited for regression trend analysis techniques. Figure 2.1 in chapter II illustrated a direct causal relationship between current and prior-year BA levels and the outlays they require. A regression model, using historical actuals between BAs and outlays, should be able to capture and predict outlays with a high degree of accuracy. At a minimum, such a model could serve as a standard method from which "initial outlay estimates" could be formulated.

### 3. The O&M Accounts

Figures 4.2 through 4.4 provide the slides DoD used to justify their FY99 O&M outlay estimates.

Appropriation: O&M, Air Force		<u>\$ In Millions</u>			
• Outlay difference		197			
• FY 1999 New BA (BA)/PY Available to Spend		25,394			
• Rate Comparison (prior year/second year rates)					
– CBO		21.6%			
– DoD		19.2%			
• Actual Experience					
		<u>FY 1994</u>	<u>FY 1995</u>	<u>FY 1996</u>	<u>FY 1997</u>
- O&M,AF second year %		16.4	21.8	21.9	19.0
• Analysis:					
- DoD O&M,AF rate is based on the average of the last four years slightly lowered to reflect the decline in WCF advanced billings.					
- The budget assumes advance billings will be liquidated by the end of FY99. The FY98 and FY99 estimates for advance billings will reflect a decline when compared to FY95, FY96 and FY97 experience.					
- The DoD rate is consistent with the execution experience but has also been adjusted to reflect both the decline in the level of advance billings after FY96 and the discontinuation of advance billings after FY99.					

Source: (DoD, Spring 1998, p. 8)

**Figure 4.2. Appropriation: O&M, Air Force**

**Appropriation: O&M, Army****\$ In Millions**

- Outlay difference 118
- FY 1999 New BA (BA)/PY Available to Spend 24,180
  
- Rate Comparison (first year)
  - CBO 75.0%
  - DoD 73.3%
- Actual Experience

	<u>FY 1994</u>	<u>FY 1995</u>	<u>FY 1996</u>	<u>FY 1997</u>
- O&M,A first year %	76.6	75.3	74.1	72.3
- Analysis:
  - DoD estimate reflects the observed declining trend and was based on an average of the last two year's worth of execution experience.
  - CBO has not recognized the declining trend in the first year outlay rate for this account.
  - This is an example of CBO employing a static rate, one that is consistent with FY95 experience and reflects an upward bias in estimating outlays for this account, given the past four years of trend data.

Source: (DoD, Spring 1998, p. 7).

**Figure 4.3. Appropriation: O&M, Army**

**Appropriation: O&M, Navy****\$ In Millions**

- Outlay difference 113
- FY 1999 New BA (BA)/PY Available to Spend 26,840
  
- Rate Comparison (second year)
  - CBO 16.4%
  - DoD 16.0%
- Actual Experience

	<u>FY 1994</u>	<u>FY 1995</u>	<u>FY 1996</u>	<u>FY 1997</u>
- O&M,N second year %	15.8	7.6	16.4	16.0
- Analysis:
  - DoD rate reflects the average execution rate for the three highest years.
  - CBO used the highest rate experienced in the last four years.

Source: (DoD, Spring 1998, p. 6).

**Figure 4.4. Appropriation: O&M, Navy**

Similar to the RDT&E, AF situation, the discrepancy between CBO and OMB-DoD in this area tends to revolve around differences in historical trend analysis. Similar arguments about the value of a “standard method” for historical trend analysis also apply to these accounts.

I mentioned earlier that there is an inherent incentive within OMB-DoD to formulate “optimistic” outlay estimates due to relatively constraining BBA outlay caps. Analysis of the three O&M slides (Figures 4.2 through 4.4) reveals that DoD’s estimates are consistently more optimistic, i.e., lower, than CBO’s. However, a review of the slides also shows that DoD is relatively consistent, at least within the RDT&E, AF and O&M accounts, when applying their trend analysis methodology.

For example, the basic DoD trend analysis method, described in section C of this chapter, revealed that they use a “mid-point range using both trend and average analysis techniques.” This mid-point technique is used to generate their RDT&E, AF estimate, as described in Figure 4.1. If we apply a similar mid-point technique to the three O&M accounts, DoD’s estimates are relatively consistent, as follows:<sup>5</sup>

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<sup>5</sup> Per Figures 4.2 through 4.4, the “rate comparison” percentages used for O&M, A were “first year” rates, while the O&M, AF and O&M, N percentages were “second year” rates. Explanation of this difference is expanded in the final paragraph of this section.

<u>Account</u>	<u>DoD's Estimate</u>	<u>Mid-Point Technique</u>
O&M, AF	19.2%	19.5%
O&M, A	73.3%	73.8%
O&M,N	16.0%	16.08% <sup>6</sup>

In contrast, CBO's O&M outlay estimates reveal no apparent trend in their outlay estimating methodology, other than a consistency toward being conservative. For example, CBO's O&M, AF outlay estimate of 21.6 percent appears to put great weight on the FY95 and FY96 levels of 21.8 and 21.9 percent, respectively, vice the declining trend exhibited by the FY97 level (19 percent). In their O&M, A estimate, the FY95 actuals of 75.3 percent appear to carry the greatest weight, despite the declining trend exhibited by the FY96 and FY97 actuals (74.1 and 72.3 percent, respectively). Finally, CBO's O&M, N estimate appears to reflect the FY96 estimate of 16.4 percent, despite lower rates in the other three years of actual data.

My point here is not that CBO's estimates are too conservative (or not conservative enough), but rather that there does not appear to be a consistent trend analysis method from which outlay estimates are derived. I suspect that CBO's actual estimating techniques are more refined and consistent than the DoD slides reveal. Unfortunately, the data I've accumulated and reviewed provide little

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<sup>6</sup> DoD notes that they excluded the FY95 rate of 7.6% (as a statistical outlier) and took a simple average of FY94, 96, and 97. This technique and resultant estimate remains similar to taking the mid point between an average of FY 94/96 and FY97.

detailed insight into CBO's specific estimating procedures, and it has already been established that a documented procedure does not exist.

More importantly, based on the DoD slides, it appears that DoD analysts also lack insight into how CBO analysts formulate their outlay estimates. This issue can only contribute to the difficulty in minimizing outlay estimate discrepancies between CBO and OMB-DoD. It's difficult to arrive at a mutual understanding about outlays when a common analytical framework for estimating outlays between CBO and OMB-DoD does not exist. At a minimum, both sides should be familiar with each other's estimating techniques in order to anticipate and minimize outlay differences due solely to a lack of shared information.

One final note about the three O&M accounts. The basis for the spend-out "rate comparison" between CBO and DoD varied between the three accounts. The O&M, A slide used a "first year" spend-out rate as the basis for comparison, while the O&M, AF, and O&M, N slides used a "second year" spend-out rate to compare CBO and DoD estimates. This begs the question as to why. Per the CBO/OMB joint report and DoD Briefing slides, the basis for spend-out rate comparison depended on two factors. First, which DoD spend-out rate was lower than CBO's estimate? In all three cases, the only DoD spend-out rate that was lower than CBO's rate was the year used, i.e., the "first year" for the Army and the "second year" for the Air Force and Navy. Second, the lower rate had to materially impact the total dollar value of the outlay estimate difference. Table

3.1 substantiates this second factor. The O&M, A estimate difference of \$118 million was primarily due to “new FY99 BA.” Thus, the first year spend-out rate comparison is the most “material” to the outlay estimate problem. This also makes it the most logical basis for comparison. Similarly, the O&M, AF and O&M, N estimate differences were most heavily influenced by “prior year BA.” Thus, it was logical that DoD would depict the second year spend-out rates as their basis for comparison and means to articulate the O&M, AF and O&M, N estimate differences. (Raines and O’Neill, 1998) (DoD, Spring 1998)

#### 4. SCN

As a procurement account, the behavior of the spend-out for SCN is much different than that of the WCF, RDT&E, and O&M accounts. Figure 4.5 provides the slide DoD used to justify their SCN outlay estimate.

DoD’s outlay estimate justification for this account follows a similar logic to their previous arguments. The problem appears to reside in large discrepancies with second year rates. As shown, DoD uses an averaging technique to justify their second year rates. In contrast CBO’s estimate is much higher than any rate experienced in the last four years.

**Appropriation: Shipbuilding and Conversion, Navy**      **\$ In Millions**

- Outlay difference 240
- FY 1999 New BA (BA)/PY Available to Spend 28,330
  
- Rate Comparison (second year)
  - CBO 25.4%
  - DoD 17.0%
- Actual Experience
 

	<u>FY 1994</u>	<u>FY 1995</u>	<u>FY 1996</u>	<u>FY 1997</u>
- SCN second year %	20.8	14.8	16.4	15.4
- Analysis:
  - Estimating difference is attributed to significant difference in projected second year rates.
  - DoD's estimate reflects an average of the past four years execution experience and also considers specific program content (the specific mix of shipbuilding programs in each year's budget request).
  - CBO's estimate exceeds any rate experience in the last four years.

Source: (DoD, Spring 1998, p. 4).

**Figure 4.5. Appropriation: Shipbuilding and Conversion, Navy**

## **V. FY99 OUTLAY ESTIMATE SOLUTION AND FUTURE IMPLICATIONS**

### **A. INTRODUCTION**

In this Chapter, I describe how the FY99 outlay estimate problem was ultimately resolved and the implications for future outlay estimate discrepancies.

### **B. DEVELOPMENT AND RESOLUTION OF THE FY99 OUTLAY ESTIMATE DISCREPANCY**

The FY99 outlay estimate problem created significant budget and readiness issues. In order for the defense committees to strictly comply with the CBO scored spending limitations, the committees would have been forced to either financially restructure defense programs, cut total defense BA, or seek relief from the budget committees. The evidence indicates that the resolution of this problem was primarily developed and implemented within the Senate. A chronology of key events associated with the development and resolution of the FY99 outlay estimate problem is provided at Appendix. Amplifying discussion on these events is provided as follows:

#### **1. Budget Estimate Submission (BES) and Review**

The President's FY99 Budget was provided to the Congress in February 1998. At the time of this submission, the CBO/OMB joint report on outlay rates had not been completed, even though Title 10 U.S.C. 226 requires completion of this report not later than 15 December. Per CBO's stated outlay-estimating process, they prepare their preliminary baseline outlay projections in December



and refine their estimates after they receive the Administration's budget. (Aycock and Fontaine, 1998) This timeline guarantees that CBO and OMB-DoD analysts will not achieve outlay consensus prior to the Administration's BES.

## **2. CBO Outlay Estimate of BES**

Based on their analysis of the Administration's budget and prior-year execution, CBO analysts reported on 4 March that OMB-DoD had underestimated FY99 defense outlays by \$3.6 billion. (CBO, 1998) On 16 March 1998, Representative Floyd D. Spence, Chairman of the House Committee on National Security, summarized his committee's frustration with the significant outlay estimate discrepancies between CBO and OMB-DoD and the compelling need for a permanent solution:

*Following its review of the President's Budget, CBO has concluded that OMB understated defense outlays by \$3.6 billion in fiscal year 1999. Last year, CBO concluded that OMB had underestimated defense outlays by \$5.6 billion in fiscal year 1998. Although CBO and OMB have traditionally had disagreements over the outlay implications of the President's defense budget request, the problem has gotten much worse over the past two years. I urge the Budget Committee to work with the Administration to develop a binding conflict resolution mechanism to resolve such disputes in advance of the annual submission of the President's Budget in the future. If such a mechanism or process is not agreed upon, I am at a loss to understand how Congress can address disputes of this magnitude within the constraints of the Balanced Budget Act of 1997's (BBA) spending caps. (Spence, 1998)*

## **3. The Stevens Amendment**

On 1 April, Senator Domenici proposed for Senator Stevens (Chairman, Senate Appropriations Committee) an amendment to the FY99 Senate Budget

Resolution designed to create a means for solving the defense outlay estimate problem. The following excerpt from the amendment highlights the key concerns associated with the problem and outlines a process for resolving it:

- *The Congressional Budget Office outlay estimate of the fiscal year 1999 Department of Defense budget request exceeds both the outlay limit imposed by the Balanced Budget Act of 1997 and the Office of Management and Budget's outlay estimate, a disagreement which would force a total restructuring of the Department of Defense's fiscal year 1999 budget.*
- *The restructuring imposed on the Department of Defense would have a devastating impact on readiness, troop morale, military quality of life, and ongoing procurement and development programs.*
- *The restructuring of the budget would be driven solely by differing statistical estimate made by capable parties.*
- *In a letter dated March 31, 1998, the Director of the Office of Management and Budget identified multiple differences between the Office of Management and Budget's estimated outlay rates and the Congressional Budget Office's estimated outlay rates.*
- *New information on Department of Defense policy changes and program execution plans now permit the Office of Management and Budget and the Congressional Budget Office to reevaluate their initial projections of fiscal year 1999 outlay rates.*
- ***Sense of the Senate:** It is the Sense of the Senate that not later than April 22, 1998, the Director of the Office of Management and Budget, and Secretary of Defense, and Director of the Congressional Budget Office shall complete discussions and develop a common estimate of the projected fiscal year 1999 outlay rates for Department of Defense accounts. (U.S. Senate, April 1998)*

The amendment offered two key provisions toward solving the FY99 outlay problem. First, it highlighted the fact that “new information” had surfaced regarding DoD policy and program execution. Senator Domenici addressed this new information and its impact in a 27 April memorandum to the chairmen of the Senate Armed Services Committee (SASC) and Senate Appropriations Committee (SAC). The information concerned outlay reductions “based on asset sales and proposed policy changes in the President's 1999 DoD budget request, including: (1) management initiatives for the Defense Working Capital Funds (DWCF) and, (2) alterations in classified activities in two Air Force accounts.” (Domenici, April 1998) In the end, these policy initiatives would serve as the primary mechanisms used to bridge the gap between CBO and OMB estimates.

Second, it provided a timetable for the parties involved to discuss and develop a consensus toward resolving the estimate discrepancy. While this suggested process proved to be significant in facilitating a solution, the relative degree of legislative authority used provides some additional insight into the outlay estimating problem. This amendment was offered only in the Senate, as part of a non-binding resolution, and in “Sense of the Senate” language. This suggests that the outlay estimating problem was of relatively limited concern within the Congress. You would expect to see more authoritative mechanisms used to address the issue if it was a high level concern throughout the Congress. Despite the use of less authoritative mechanisms, it was clear that the FY99 outlay

problem was a significant issue to the committees most directly involved, at least in the Senate.

#### **4. The FY99 CBO/OMB Joint Report on Outlays**

On 2 April, the directors of CBO and OMB issued a joint report detailing the FY99 defense outlay estimate differences between CBO and OMB. These differences (more refined than CBO's preliminary \$3.6 billion estimate) were summarized in Chapter III and totaled \$3.7 billion. The joint report described in 051 "account-level" detail the primary areas of outlay disagreement between the two agencies.

#### **5. Senator Domenici's 27 April Memorandum**

During April 1998, parties from CBO, OMB, and DoD met as directed. "The discussions did not resolve the technical matters at issue, but did lead to a potential alternative means of ameliorating the problem, at least in the Senate." (Daggett, May 1998, p. 16) As a result of these discussions, Senator Domenici sent a memorandum on 27 April to the chairmen of the SASC and SAC. In that memorandum, he recommended that the defense authorization and appropriation bills take three policy steps designed to reduce FY99 defense outlays. These policy steps related to the defense WCFs, classified account policies, and DoD asset sales.

First, Senator Domenici committed to score the FY99 Senate Appropriations and Authorization Bills recognizing the Administration's outlay estimates if

legislation was passed directing DoD management initiatives within the WCFs. Second, the Senator agreed to defer to the judgement of the chairmen that certain classified DoD policy initiatives would have the downward impact on outlays asserted by DoD. If given assurances from the chairmen concerning outlay reductions in this area, he would score the Senate Appropriations and Authorization legislation in accordance with DoD estimates. Third, he wrote that "if legislation provides for defense asset sales subject to appropriations, appropriate savings will be scored." (Domenici, April 1998) Under the auspices of the Steven's Amendment, CBO, OMB, and DoD estimated that these three initiatives would produce between \$2.6 and \$2.9 billion in outlay scoring reductions. (Domenici, April 1998)

#### **6. Senate FY99 Defense Authorization Bill**

On 11 May, the Senate Armed Services Committee reported out its FY99 Defense Authorization bill. Per Senator Domenici's 27 April memorandum, the bill included specific legislative provisions that reduced outlay estimates.

First, section 341 addressed the liquidity of FY99 WCFs.

*The Secretary of Defense shall administer the working-capital funds of the Department of Defense during fiscal year 1999 so as to ensure that the total amount of cash balances in such funds on September 30, 1999, exceeds the total amount of cash balances in such funds on September 30, 1998, by \$1,300,000,000. (U.S. Senate, S. 2060, 1998, p. 58)*

Second, the bill included provisions concerning Navy asset sales. Section 1013 of the Senate-passed Authorization bill provided a detailed list of ships

eligible for transfer to foreign countries. Paragraphs b and c of section 1013 reflected the ships authorized for sale and lease, respectively. (U.S. Senate, S. 2060, 1998, pp. 198-200)

Third, the bill included a second provision concerning DoD asset sales that authorized the disposal of excess materials from the National Defense Stockpile. This provision was designed to generate receipts for the United States. (U.S. Senate, Report 105-189, 1998, p. 433)

In addition to legislative language, Senator Domenici requested in his 27 April memorandum that the chairmen of the SASC and SAC provide assurances concerning outlay reductions associated with certain classified DoD policy initiatives. The limited evidence on this issue indicates that Senator Domenici received these assurances via his staff. On 21 May, a memorandum to the Senator from his staff referenced these assurances as follows: "The Armed Services Committee staff has provided the requested assurances that its actions on two classified Air Force accounts will retard 1999 outlays by at least \$0.7 billion." (Wheeler, 1998)

#### **7. Senate FY99 Defense Appropriations Bill**

On 2 June, the Senate Appropriations Committee reported out the FY99 Defense Appropriations bill. Committee action included the consolidation of funding for the Pentagon's ongoing renovation project from the service and defense-wide O&M accounts into a separate fund. (U.S. Senate, June 1998, p. 14)

This transfer is relevant to the outlay problem because this new Pentagon Renovation Transfer Fund is expected to have a lower spend-out rate than the O&M accounts from which the money was transferred. (Hoagland, n.d.)

#### **8. The FY99 Defense Authorization Bill**

The Senate and House passed the conference agreement on the FY99 Defense Authorization bill on 22 September 1998. The bill included the WCF and Navy and Defense Stockpile asset sale provisions as provided for in the Senate-passed version of the legislation. (U.S. House, September 1998, pp. 705, 732, and pp. 826-27)

#### **9. The FY99 Defense Appropriations Bill**

The Senate and House passed the conference agreement on the FY99 Defense Appropriations bill on 25 September 1998. The bill included the Senate's Pentagon Renovation Transfer provision. (U.S. House, September 1998, p. 9)

#### **10. Summary of Outlay Adjustments**

On 2 December 1998, I interviewed Mr. G.W. Hoagland, Staff Director for Senator Domenici, concerning the FY99 outlay problem. This interview confirmed that Senator Domenici's "three policy steps" served as the basis for the ultimate resolution of the issue. Mr. Hoagland provided a table that summarized the specific outlay scoring adjustments made to FY99 national defense legislation.

As indicated in Table 5.1, total adjustments reflected a \$2.927 billion reduction to outlay estimates. The \$2.927 billion adjustment consisted of two

**Table 5.1. Outlay Adjustments to FY99 National Defense Legislation**

<b>Outlay Adjustments to FY99 National Defense Legislation</b> (\$ billions)		
<b>Description</b>	<b>SBC Adjustment</b> (based on Legislation)	<b>CBO Scoring</b>
1. Maintain Larger On-hand Cash in WCF	1.300	
2. Adhere to Administration Policies in Classified AF Accounts	0.700	
3. National Defense Stockpile Sales		0.100
4. Sales of Retired U.S. Navy Ships		0.637
5. Separate Pentagon Renovation Transfer Fund	0.190	
<b>TOTAL</b>	<b>2.190</b>	<b>0.737</b>
<b>GRAND TOTAL</b>		<b>2.927</b>

Source: (Hoagland, n.d.).

parts. First, \$2.190 billion in outlay scoring adjustments were originally exercised, in the accounts listed, by Senator Domenici under the auspices of the Senate Budget Committee. (Domenici, April 1998) These provisions were eventually adopted into national defense legislation as previously described. Second, CBO scoring adjustments totaling \$0.737 billion were made, in the accounts listed, based on other provisions adopted during the FY99 legislative process. Once again, these provisions were initiated in the Senate.

While the \$2.927 billion adjustment remained short of the \$3.7 billion original outlay estimate difference, the evidence indicates that this level of adjustment was sufficient to “fix” the problem. Commenting on the defense outlay problem during Senate debate on the FY99 Defense Appropriations Bill,



Senator Domenici argued that this amount closed the original \$3.7 billion outlay gap between CBO and OMB-DoD “to manageable dimensions.” (Domenici, July 1998) A summary of each of the outlay adjustments presented in Table 5.1 is provided.

*a. Maintain Larger On-hand Cash in WCF*

This policy assumption represented the largest area of disagreement, in terms of outlay dollars, between CBO and OMB-DoD analysts. As indicated in the original “Domenici solution,” this scoring adjustment was dependent on detailing specific DoD policy initiatives in legislation. The WCF provisions were introduced in Sections 341-42 of the Senate-passed FY99 Defense Authorization bill. (U.S. Senate, S. 2060, 1998, p. 58) This provision was adopted by both the Senate and House and included in Section 1007 of the final FY99 Defense Authorization Act. The provision addresses the liquidity of DOD’s WCFs and requires that the cash balances at the close of FY99 exceed \$1.3 billion. (Public Law, 105-261, Section 1007, 1998)

*b. Adhere to Administration Policies in Classified AF Accounts*

This adjustment reflects the second “policy step” proposed by Senator Domenici in his 27 April memorandum. Specifically, these adjustments result from “administrative initiatives” within two classified Air Force accounts (Other Procurement and R&D). (Hoagland, n.d.) As indicated previously,

judgement concerning the validity of this scoring adjustment was deferred to the defense committee chairmen and ultimately reflected DoD estimates.

*c. National Defense Stockpile Sales and Sales of Retired U.S. Navy Ships*

These adjustments represented the increased asset sales referred to in the third Domenici "policy step." CBO scoring was adjusted based on legislation enacted concerning these two asset accounts. Similar to the WCF issue, these two legislative provisions were first introduced in the Senate as part of their FY99 Defense Authorization Bill. In both cases, the House adopted the provisions and they became law.

Section 3303 of the Senate-passed FY99 Authorization Bill directed the disposal of materials from the National Defense Stockpile. The provision was adopted by the Senate and House and included in Section 3303 of the FY99 Defense Authorization Act. Specifically, the Act directs the President to dispose of materials in the National Defense Stockpile "so as to result in receipts to the United States in the amount of \$105 million by the end of fiscal year 1999." (Public Law 105-261, Section 3303, 1998) As indicated in Table 5.1, CBO ultimately scored the FY99 stockpile sales at \$100 million.

Section 1013 of the Senate-passed FY99 Authorization Bill provides a detailed list of ships eligible for transfer to foreign countries. This provision was adopted by the Senate and House and included in Section 1235 of the FY99 Defense Authorization Act. Paragraphs b and c of section 1235 reflect the ships

authorized for sale and lease, respectively. As illustrated in Table 5.1, CBO derived \$637 million in outlay adjustments based on the content of this legislation. (Public Law 105-261, Section 1235, 1998) (Hoagland, n.d.)

*d. Separate Pentagon Renovation Transfer Fund*

This adjustment surfaced during the Hoagland interview. It reflects a new Pentagon Renovation Fund included in the FY99 Appropriations Bill. The fund was created via a \$280 million transfer from O&M (Public Law 105-2620, 1998) and is expected to execute consistent with the relatively slow spend-out characteristics of a military construction account. Given that the funds were transferred from high spend-out rate O&M accounts, CBO determined that a \$190 million adjustment for FY99 outlays was appropriate. (Hoagland, n.d.)

In sum, achieving an FY99 outlay estimate solution required a high degree of collaboration between the key constituencies involved. These collaborations helped facilitate policy consensus on several issues. Regarding the \$1.3 billion WCF adjustment, DoD argued for a change to WCF policy that would allow them to retain larger cash balances. CBO's initial outlay estimates reflected a more traditional WCF cash policy. The DoD policy change was eventually adopted, but only after specific legislation was enacted to promote enforcement.

Similarly, the \$700 million adjustment to the classified Air Force accounts was scored once the parties agreed to adopt DoD policy assumptions concerning "administrative initiatives" within these accounts. These initiatives

were not specifically legislated, but assurances were provided to Senator Domenici and his staff from staffs within the SASC and SAC. (Hoagland, n.d.)

Finally, the remaining three accounts, totaling \$927 million, reflected scoring adjustments based on other policy and legislative initiatives that surfaced during congressional budget process negotiations.

Of the original \$3.7 billion outlay estimate difference, the Congress addressed \$2.927 billion during their development and enactment of FY99 national defense legislation. Senator Domenici confirmed on the Senate floor that these actions reduced the outlay estimate problem to "manageable dimensions." (Domenici, July 1998) Consequently, the actions avoided the negative effects on readiness and modernization that were feared in the event the defense committees would have been forced to strictly comply with the original CBO scored spending limitations.

Open communication channels between key constituencies appear to be the linchpin that links all these outlay estimate solutions. Open communication and a high degree of collaboration is particularly critical between CBO and OMB-DoD analysts who must ultimately develop the detailed solutions required to solve these complex issues.

### **C. IMPLICATIONS FOR FUTURE OUTLAY ESTIMATE DISCREPANCIES**

Given the lack of progress on improving the outlay estimating process between CBO and OMB, congressional frustration with continuing outlay estimate disagreements remain. Chairman Spence's 16 March letter clearly illustrates this high level of frustration. (Spence, 1998)

During the FY99 process, Senator Domenici also expressed his position regarding key elements he considered vital toward improving the outlay estimating process. Specific items addressed by the Senator included timely submission of the annual CBO/OMB joint report, close coordination between CBO and OMB-DoD analysts throughout the budget and legislative processes, completion of detailed joint analysis by CBO and the Administration of past outlay estimate differences, and timely explanation and justification by DoD of policy changes that, in DoD's judgement, CBO failed to recognize during the scoring process. (Domenici, April 1998)

Despite congressional concerns and prior legislative action, the evidence reveals that little has been done to improve the overall outlay estimating process between CBO and OMB-DoD. CBO and OMB-DoD failed to meet the 15 December FY00 joint report deadline. (Gallo, February 1999) CBO reported a preliminary FY00 outlay estimate imbalance of \$10 billion. (CBO, 1999) The joint report format does not address the policy and technical assumptions used to develop outlay estimates. (Raines and O'Neill, 1998) A documented analytical

method to estimate outlays does not exist in either CBO or OMB-DoD. (Gallo, February 1999)

An OMB outlay analyst summed up the status of near-term improvements to the outlay estimation process as follows: "I can say that no new policies have been implemented as a result of the FY99 difference." (Gallo, February 1999) As a consequence, I suspect significant outlay estimate discrepancies will continue until reforms, like those recommended by Senator Domenici, are effectively implemented. This assertion is strongly substantiated by the FY00 \$10 billion preliminary outlay estimate discrepancy between CBO and OMB-DoD. (CBO, 1999)



## **VI. CONCLUSIONS, RECOMMENDATIONS, AND FURTHER STUDY POTENTIAL**

### **A. INTRODUCTION**

The final chapter of this thesis summarizes previously developed issues and findings regarding the FY99 outlay estimate problem. Conclusions and observations are offered regarding both the causal factors that contributed to the FY99 problem and its ultimate solution. In addition, management actions designed to minimize future outlay estimate problems are recommended.

The chapter is divided into four sections. First, it reviews the key causal factors associated with the FY99 outlay estimate problem. The second section of the chapter focuses on the solution that emerged in response to this problem. Observations are offered regarding the applicability of the FY99 solution to future outlay estimate problems. The third section draws on the conclusions and observations offered in the first two sections and recommends potential management actions designed to minimize future outlay estimate discrepancies. Finally, the fourth section suggests possible areas for further study concerning this issue.



## **B. IDENTIFICATION AND ASSESSMENT OF CAUSAL FACTORS ASSOCIATED WITH THE FY99 OUTLAY ESTIMATE PROBLEM**

Several causal factors associated with the FY99 outlay estimate problem were discussed in Chapter IV. In this section, I highlight and assess those key factors that were most contributory to the FY99 outlay problem.

### **1. WCF Policy**

The WCF outlay estimate discrepancy of \$1,364M was the largest area of disagreement, in terms of outlay dollars, between CBO and OMB-DoD analysts. As I have discussed, the nature of estimating WCF outlays is complex. However, the policy difference that drove the FY99 WCF outlay estimate discrepancy is rather straightforward. Prior-year DoD WCF execution data revealed substantial financial losses within the fund. DoD policy requires that these losses be recovered to ensure solvency of the fund. Consequently, DoD projected that approximately \$1,587M in net cash from other DoD sources would not be used during FY99 WCF operations, i.e., they would not create obligations/ disbursements with the accumulated cash. The net effect of this policy action was a negative outlay to the budget sub-function 051 bottom-line.

In contrast, CBO analysts assumed the more traditional DoD WCF policy of a net operating result (NOR) closer to zero. Thus, it's perfectly logical that CBO's FY99 outlay estimate reflects a much lower negative outlay. In fact, CBO's FY99 outlay estimate projected a \$223M negative outlay. Thus, an outlay discrepancy of \$1,364M between CBO and OMB-DoD occurred. As discussed in

Chapter V, resolution of this policy disagreement was the single biggest element within the congressional FY99 outlay estimate solution.

## **2. The Outlay Estimating Process**

Congress recognized that there were several procedural problems associated with the estimating process, and legislation was passed in the late 1980s designed to improve the process by ensuring CBO and OMB worked together toward minimizing outlay estimate disagreements. Yet, the evidence is clear that the intent of the legislation is not being followed by either CBO or OMB-DoD. First, the CBO/OMB FY99 joint report was not completed in time to serve as a viable FY99 budgetary planning document. The same thing happened with respect to the FY00 budget. As a result, CBO reported a preliminary FY00 outlay estimate difference between CBO and OMB-DoD of \$10 billion. Finally, the content of the current joint report falls short of resolving outlay estimate discrepancies and explaining the technical assumptions used to derive those estimates. Rather, it serves to simply document the amount of disagreement between CBO and OMB-DoD.

It is difficult to determine how successful a CBO/OMB joint review process would be if the entire process were to be conducted prior to the Budget's February submission. What is clear, however, is that failure to meet the 15 December joint report deadline and to enhance the substance of the report will continue to undermine the intent of the 1980s legislation. As a consequence,

significant outlay estimate disagreements will continue to pass unresolved to the congressional committees for final resolution.

### **3. Outlay Estimate Analytical Methodology**

Discussions with CBO and OMB analysts confirm that a consistent and documented analytical method for estimating outlays does not exist within or between the agencies. DoD FY99 outlay estimate justification reveals that the variances between CBO and OMB-DoD in estimating methodology, specifically historical trend analysis, is the primary reason for different outlay estimates in the RDT&E, O&M, and SCN account areas. As presented in paragraph B.2 above, a more timely and effective outlay estimating process could serve to resolve these differences prior to budget submission. Short of such an effective process however, a documented joint estimating methodology that established trend analysis parameters for each appropriation title would assist CBO and OMB-DoD analysts in their mutual quest for realistic and comparable estimates.

### **4. Variability Within DoD Programs**

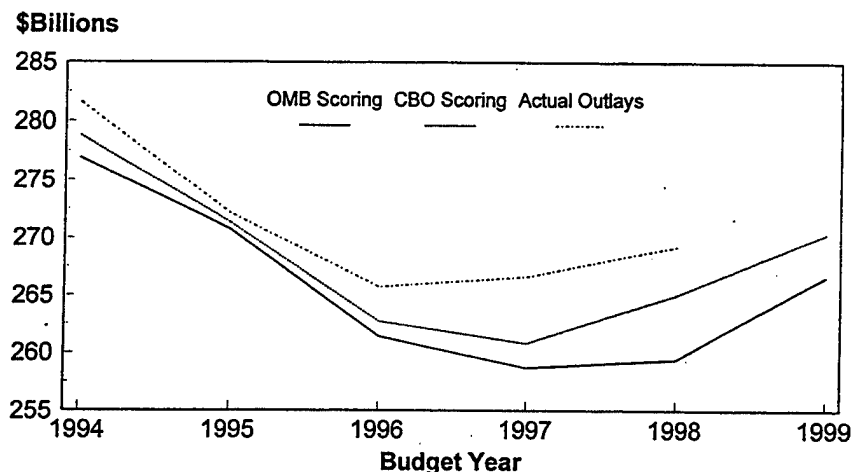
The inherent variability and complexities of the DoD's many programs also account for the fact that equally competent analysts will often disagree concerning outlay estimate projections. Factors that illustrate this variability and complexity include the long lead-time required for budget preparation, the limited amount of recent historical data, the complexity of tracking the amount and timing

of DoD legislative transfer authority, and the significant impact of WCF policy changes on the timing and amount of future disbursements. (Aycock and Fontaine, 1998, pp. 7, 12-14)

Figure 6.1 illustrates the recent history of differences between CBO and OMB in estimating defense outlays. It indicates that outlay estimates over the past several years have been underestimated by both CBO and OMB-DoD. However, CBO estimates have been consistently more accurate than OMB-DoD estimates.

### OUTLAY ESTIMATES

CBO & OMB Scoring of Requests  
Compared to Actuals  
Budget Function 050



The 1998 actuals is a preliminary CBO estimate.

Source: (CBO, Budget Authority and Outlay Estimates 1994 Through 1999, n.d.).

**Figure 6.1. Outlay Estimates CBO & OMB Scoring of Requests**

This fact would support congressional deference to CBO's more conservative outlay estimates and methodology. However, as the FY99 solution revealed, this did not seem to heavily influence congressional decision-makers, since much of what OMB-DoD proposed and defended was eventually adopted.

I point to the inherent variability and complexities summarized by Aycock and Fontaine to help explain why it is difficult for CBO or Congress to refute Administration estimates. Given these inherent problems, all parties involved must be "realistic" about the level of precision obtainable when estimating DoD outlays. Although the \$3.7 billion estimate difference for FY99 is large in real terms, it represents only approximately 1.5 percent of the total DoD budget for that year. Thus, challenging outlay estimates when the difference reflects such a relatively small portion of the budget is likely to occur only when strict constraints on outlays are operative, as they were for FY99.

One final note about causal factors associated with the FY99 outlay estimate problem. Prior-year outlay estimate problems were explored to determine if significant and relevant patterns existed which could provide additional insight into the FY99 problem. Several documents that addressed outlay estimate problems in the late 1980s were reviewed. These documents offered little specific insight into the FY99 problem, but did confirm that the procedural issues that plagued the FY99 process have been present for some time. As with FY99, the outlay estimate differences in the late 1980s involved disagreements between CBO

and OMB-DoD regarding defense policy assumptions and implementation associated with O&M spend-out rates and revolving funds (synonymous with FY99 WCF). For example, CBO's outlay estimate for FY90 was \$3.8 billion higher than estimates submitted by DoD. Of that difference, \$2.1 billion was attributed to variances in O&M spending rates and \$1 billion was due to the timing of disbursements within the revolving fund accounts. Both of these issues illustrate policy issues similar to those we surfaced regarding the FY99 problem. (Cheney, June and July 1989)

The FY98 outlay estimate difference of \$5.6 billion also offered the potential for insight regarding the FY99 problem. However, this discrepancy never generated the level of congressional interest and debate offered by the FY99 problem. (Wheeler, 1999) The evidence indicates that the strict BBA outlay limitations, which proved to be the catalyst for congressional interest in FY99, were not enacted until late summer 1997. (Elving and Taylor, 1997) The DoD and congressional budget cycles suggest that CBO and OMB-DoD outlay estimate differences for the upcoming year logically surface in early spring. Clearly the timeline provided in the Appendix illustrates this logic, i.e., CBO refines and reports their outlay estimate after they receive the President's budget in February. Therefore, the FY98 BBA outlay constraints were not a factor during the spring of 1997, when the \$5.6 billion outlay difference was surfaced by CBO. (Wheeler, 1999) Consequently, the FY98 outlay issue did not generate the high level of

congressional interest experienced during FY99, when the outlay problem was essentially the "test-case" for enforcing the agreed upon BBA outlay limitations. In fact, there was so little congressional interest in the FY98 outlay difference that the FY98 joint CBO/OMB outlay report to the Budget Committees (and others) was never completed. (Gallo, March 1999)

### **C. THE FY99 OUTLAY ESTIMATE SOLUTION**

The FY99 outlay estimate problem generated important defense budget and readiness issues. CBO's estimate of DoD's FY99 outlays was \$3.7 billion higher than the Department's estimate. Under the CBO estimate, the Department's outlays would exceed FY99 defense spending targets established in both the Senate-passed FY99 Budget Resolution and the 1997 Balanced Budget Act (BBA).

Given these budget concerns, the congressional defense committees had three alternatives. They could either financially restructure defense programs, cut defense BA levels, or request relief from the Budget Committees. Congressional and DoD experts agreed that the first two alternatives, restructuring or cutting the defense budget, were untenable since their implementation "would have a devastating impact" on defense readiness. (U.S. Senate, April 1998) Thus, the defense committees worked with the Budget Committees in formulating a solution.

Specifically, the solution to the FY99 outlay estimate problem was primarily developed and implemented within the Senate. The Appendix provides a chronology of significant events associated with this solution. In the end, the FY99 outlay estimate solution revealed the importance of collaboration among key congressional players. These included primarily the Senate Budget Committee (SBC), CBO, OMB, and DoD. This collaboration facilitated policy consensus, in large part underwritten in legislation, on several issues important to reducing CBO's FY99 outlay estimates.

The issues involved in the FY99 outlay estimate solution related to WCF policy, administration policies in two classified Air Force Accounts, asset sales from the National Defense Stockpile and the U.S. Navy, and the transfer of O&M dollars to the Pentagon Renovation Transfer Fund. With regard to WCF policy, DoD successfully argued for the need to retain larger cash balances. The net effect of this policy change was an outlay estimate adjustment of \$1.3 billion. It is important to note that this estimate adjustment was scored only after specific legislation was enacted effecting the policy change.

As part of the outlay estimate negotiations, \$700 million in defense outlay savings were scored within two classified Air Force accounts. The savings related to unspecified "administrative initiatives" within these two accounts. Although specific legislation addressing these initiatives was not adopted, Senator Domenici



was provided assurances from the Senate defense committees regarding the validity of the scoring adjustments.

An additional \$737 million in FY99 outlay savings was scored based on asset sales within two DoD accounts. These adjustments were based on legislation related to sales affecting the National Defense Stockpile and several retired U.S. Navy ships.

Finally, \$190 million in outlay savings was scored based on legislation directing the transfer of O&M dollars to the Pentagon Renovation Transfer Fund. Since the Pentagon Renovation Transfer Fund is expected to execute at a slower spend-out rate than O&M, the outlay savings were determined to be applicable.

As a result of these policy actions, the original \$3.7 billion estimate problem was reduced by \$2.927 billion. Senator Domenici referred to the remaining outlay estimate difference of \$.773 billion as a "manageable" problem. Consequently, the policy actions undertaken avoided the negative effects on readiness that had originally been feared.

#### **D. OBSERVATIONS REGARDING THE FY99 SOLUTION**

The driving force behind the heightened congressional interest in the FY99 outlay estimate problem appeared to be the outlay limits imposed by the Balanced Budget Act (BBA) of 1997. Supported by CBO analysis, the Congress (primarily the Senate Budget, Armed Services and Appropriations Committees) felt that the

Administration's FY99 budget request generated outlays that exceeded the bipartisan BBA limits.

It has been established that the BBA, and earlier budget process reforms, reflect legislation developed primarily to reduce the deficit. Robert Reischauer notes that deficits (and deficit reduction) have underscored "many important but divisive questions involving the philosophy of government..." over the last 20 years. (Reischauer, 1997) Given the importance deficits have played within the U.S. political landscape, it's not surprising that proponents of deficit reduction are firmly committed to adhering to the outlay limits imposed by the BBA.

Thus, when it was determined by CBO that the Administration had exceeded these limits, powerful budget leaders within the Congress took special interest in highlighting and rectifying the problem. Following Senators Domenici and Steven's lead, the Congress solved the FY99 outlay problem by bringing together the key players concerned, finding and developing policy consensus that generated outlay savings within the budget, and by implementing those policies through legislative provisions and member assurances.

It has been indicated that the preliminary FY00 outlay estimate difference totals approximately \$10 billion. The composition of that difference suggests that much of it appears similar to, although much larger than, the FY99 problem.

*Of the \$10 billion, about \$6 billion can be attributed to the differences in analytical judgement about spend-out rates for new appropriations and assumptions about the timing of disbursements of unexpended balances that have generated differences in the past.*

*The remaining \$4 billion difference can be traced to the Administration's not including in the defense budget the outlays from 1999 contingent emergency appropriation funding that had not been released at the time the budget was presented to the Congress, and to different estimates of the effect of an assortment of proposed changes in Department of Defense practices. (CBO, March 1999)*

CBO's comments illustrate three areas where similarities exist between the FY99 and FY00 estimate differences. First, the variability in analytical trend analysis interpretation is similar to the problems experienced in the FY99 R&D and O&M accounts. Second, FY99 WCF differences revolved around disputes over the timing of disbursements. Finally, changes to DoD "practices" appears similar to varying policy interpretations between CBO and DoD analysts, which was a similar phenomenon highlighted in FY99.

Given these similarities, finding budget policy consensus through collaboration will be required, as it was in FY99. A high degree of congressional interest could also produce legislative provisions designed to implement outlay savings agreements reached through this collaborative effort.

However, several factors indicate that similar "legislative solutions" in FY00 would be more problematic. First, the magnitude of the problem is obviously much larger. It's logical to assume that crafting legislation designed to reduce outlays by approximately \$10 billion would be significantly more difficult than addressing the \$3.7 billion problem in FY99.

Second, CBO forecasts federal budget surpluses for the next several years. (CBO, January 1999, p. 1) Over the past 20 years, deficits have helped substantiate the policy arguments for discretionary spending reform and/or reductions. Without deficits, it's highly probable that outlay caps or outlay estimate differences will generate less concern within the Congress. Although the estimating problem may continue to generate concern within the committees most directly involved, the political capital required to enact legislative solutions may be difficult to muster in a "surplus" environment.

The BBA outlay caps, the DoD "readiness crisis", and this emerging "surplus" environment provide the context within which the outlay issue will be addressed in the future. Recent history illustrates this conflicting contextual environment. This thesis discusses a rather intense and comprehensive struggle to constrain defense outlays as part of a larger policy to control deficits via the BBA spending limits. It has been shown that this struggle led to passage of FY99 defense authorization and appropriations legislation that included provisions designed to implement outlay savings agreements.

As the FY99 Authorization and Appropriations Bills were being completed, Congress was confronted with the DoD "readiness crisis". "In September 1998, congressional Republicans and the Joint Chiefs of Staff clashed publicly over the readiness of today's U.S. military and the truthfulness of previous testimony that the Chiefs had delivered to Congress." (Brookings Institute, 1999) This debate

led to congressional demands for an FY99 "emergency" defense-related supplemental.

The "emergency" supplemental appropriation eventually enacted in October 1998 provided \$7.586 billion in new BA for defense, with a corresponding increase to FY99 outlays of \$5.849 billion. (CBO, 16 March 1999) In accordance with BBA rules, this supplemental does not "count" against the BBA spending limits, i.e., it's "free money" within the context of the politically charged BBA.

Prior to the "surplus" environment, member concerns about the deficit would help limit this type of spending. An indication of this concern is vividly illustrated by this thesis. Deficits have fueled budget policy arguments and led to discretionary spending reforms, including the BBA spending limitations. We have shown that the \$3.7 billion outlay estimate difference generated significant concern and action within the Congress because they felt the Administration had violated the BBA spending limits on outlays.

Although the deficit is no longer an issue, many members remain concerned about the political consequences associated with openly breaching the BBA limits. On the other hand, many in Congress believe we face a very real "readiness crisis" and modernization backlog brought on by years of inadequate defense budgets. Given these conflicting factors, it is not surprising that Congress has used the "emergency supplemental" as a vehicle to increase funding for defense.

The Kosovo crisis and related funding action offers a similar example of using this approach to increase defense funding. The crisis has prompted the President to request \$5.5 billion in emergency supplemental appropriations in support of DoD operations. Congress ended up approving an "emergency" supplemental worth \$11.5 billion for the crisis in Kosovo. (U.S. House of Representatives, May 1999) This action hardly reflects a Congress oriented toward spending control. Although many other political issues may be reflected in this congressional action, it does appear that spending control was not an important issue in its deliberations.

A similar phenomenon is present in FY00. After several years of real (after inflation) decline in defense funding, the President's FY00 Defense Budget reflects "an end to the decline in military funding that has been underway since the mid-1980s." (Daggett, 1999) The Administration's budget request basically holds the line in FY00 (-0.6 percent real decline) and reflects a 4.4 percent increase in FY01. (Daggett, 1999) However, many members in Congress continue to believe that the level of growth reflected in the President's request is insufficient. Consequently, the Congress has approved in their FY00 Concurrent Resolution an \$8 billion increase (over the President's request) for defense. (U.S. House of Representatives, April 1999) The dilemma for congressional members who support this increase in defense is similar to the conflicting budgetary factors they faced in FY99. They support defense increases but would prefer to remain within

the BBA established spending caps. However, "to stay within the caps while giving defense the increase they want will require sharp cuts elsewhere." (Washington Post, 1999)

In sum, the "readiness crisis" and modernization problems and the lure of budget surpluses are making it increasingly difficult for Congress to fund defense at the level they feel is necessary while abiding by the BBA limits. In FY99 it appears that "emergency" supplementals are providing some short-term relief to their political dilemma. This is the context within which future outlay estimate issues will be addressed.

Finally, the details surrounding the FY99 legislative solutions do not appear to offer sustainable adjustments to outlays. Two examples from the FY99 solution help illustrate this point. First, the WCF legislation is clearly a one-time adjustment. DoD needed to generate the excess cash within these accounts due to prior-year losses. The FY99 "negative outlay" is only applicable to FY99, unless similar losses continue to accrue. Second, the outlay savings associated with DoD asset sales reflect single events designed to generate revenue. They do not reflect sustainable outlay reduction mechanisms. Asset sales should be based on DoD policy decisions and not used to reduce outlays below prescribed spending limits.

It's unclear whether the classified administrative initiatives or the Pentagon Renovation Transfer Fund reflect sustainable adjustments for future outlay

estimates. However, it's likely that these initiatives offer a "one-time" opportunity to reduce outlays within the FY99 budget.

## **E. RECOMMENDATIONS**

Two fundamental management actions are recommended to minimize outlay estimate problems in the future. While the management actions suggested appear straightforward, the reader should appreciate the difficulty associated with implementing these actions considering the complexity of both the budget process and the data involved.

### **1. Overall Process Improvements**

Problems stemming from the outlay estimating process revolved around the inability to determine and coordinate vital information in a timely manner. It has been shown that CBO and OMB failed to meet either the FY99 or FY00 joint report deadline of 15 December. Their failure in meeting these deadlines strongly suggests that information key to minimizing outlay estimate differences was either not available or not shared prior to budget submission. In addition, the content of the final report also suggests that the information being developed and shared via the joint reporting process was insufficient to resolve the policy and technical assumptions critical to minimizing the outlay estimate differences between the two agencies.

For example, the WCF discrepancy suggests that despite the joint reporting process, a significant policy assumption concerning WCF cash accumulation was



not sufficiently conveyed between applicable analysts. The apparent inability of the current reporting process to highlight the impact of even this "significant" policy assumption represents an ominous sign of the deficiencies associated with the existing process. It has been established that the inherent variability and complexity of DoD's many programs make outlay estimation an extremely complex task. Without open and timely information exchange between applicable analysts, achieving comparable outlay estimates prior to budget submission becomes next to impossible.

The obvious solution to this information problem is to improve the substance of the joint process and report and to meet the 15 December deadline. It is clear from the 1980s legislation directing the requirements associated with the joint CBO/OMB outlay estimating process that the intent was to address key policy and technical issues prior to submission of the budget in order to minimize outlay differences. Representative Spence goes as far as to suggest that a "binding conflict resolution mechanism...or process" (Spence, 1998) should be developed to resolve outlay disputes prior to budget submission.

Senator Domenici's recommendations for improving the process best summarize the management actions required. These recommendations included timely submission of the joint report, close coordination between CBO and OMB-DoD analysts, joint analysis of past outlay estimate differences, and timely

explanation and justification of DoD policy changes significantly impacting historical outlay rates. (Domenici, April 1998)

## **2. Analytical Method Improvements**

It is recommended that CBO and OMB-DoD analysts develop and document a joint analytical model for estimating outlays. It has been shown that a documented analytical method for estimating outlays does not exist within either CBO or OMB-DoD. This fact clearly exacerbates the difficulties associated with minimizing the outlay differences between the two agencies.

A joint analytical method that establishes similar statistical approaches would help minimize the differences in outlay estimates. Consistent statistical trend analysis methods and parameters could be established within each account, e.g., O&M, RDT&E, designed to clearly link outlay estimates to a given level of BA. Specifying these methods and parameters and incorporating them in a broader mathematical model would unequivocally establish "initial outlay estimates" derived from historical data. The overall outlay estimating process could then allow for policy arguments and focused debate when either agency wanted to deviate from the established norm.

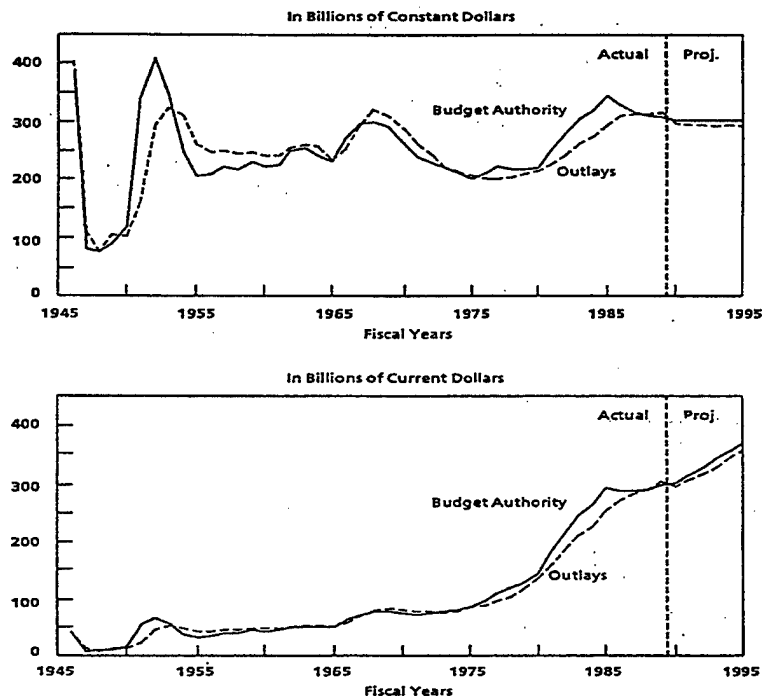
## **F. FURTHER STUDY POTENTIAL**

This thesis focused on identifying and analyzing the primary causal factors associated with the FY99 outlay discrepancy between CBO and OMB-DoD. Clearly, congressional legislation and member statements are directed toward

improving the procedural coordination, timing of input, and historical understanding of the outlay estimating process. To this end and from an analytical perspective, further research is required to develop the mathematical models capable of linking BA and outlays.

A regression model might be a viable approach to pursue. A regression model using BA levels as the independent variable should be able to capture and predict outlays (the dependent variable) with a high degree of accuracy. Figure 2.1 in Chapter II illustrated a causal direct relationship between current and prior-year BA levels and the outlays they require. Figure 6.2 plots Defense BA and outlay levels between 1945 and 1995.

### Defense Budget Authority and Outlays



SOURCE: Congressional Budget Office.

Source: (CBO, Budget Authority and Outlay Estimates 1994 - 1999, n.d).

### Figure 6.2. Defense Budget and Outlays

These graphs appear to illustrate that BA and outlay levels possess a high degree of historical correlation. This fact suggests that a regression model (or multiple models at the account level) could be developed that use BA levels to forecast future outlays. Development of viable regression models could serve as a standard analytical method from which "initial outlay estimates" could be formulated. In this way, progress toward achieving a better understanding of the outlay estimating process, particularly with respect to the individual accounts, would be accomplished.



**APPENDIX. A CHRONOLOGY OF THE SIGNIFICANT  
EVENTS ASSOCIATED WITH THE DEVELOP-  
MENT AND RESOLUTION OF THE FY 1999  
OUTLAY ESTIMATE DIFFERENCE BETWEEN  
CBO AND OMB-DOD**

<u>Date</u>	<u>Event</u>
2 February 1998	The FY99 President's budget is released.
4 March 1998	CBO's preliminary estimate of FY99 outlays is released. CBO's outlay estimate is \$3.6 billion above the Administration's estimate.
1 April 1998	The Steven's Amendment to the FY99 Senate Budget Resolution is offered. The Amendment addresses the FY99 defense outlay problem and proposes a means for resolving most of it.
2 April 1998	The CBO/OMB FY99 Joint Report on Defense Outlays is released, providing account-level detail concerning the FY99 outlay estimate difference between CBO and OMB-DoD. The difference is \$3.7 billion.
April 1998	Per the Steven's Amendment, CBO, OMB, and DoD officials meet and develop alternatives for resolving the outlay problem.
27 April 1998	Senator Domenici, Chairman of the Senate Budget Committee, sends a memorandum to the chairmen of the Senate Armed Services and Appropriations Committees concerning the FY99 outlay problem. The Senator proposes three policy steps designed to reduce outlays. These steps relate to defense working capital funds (WCFs), administration policies in classified Air Force accounts, and asset sales. All three policy steps would result in reduced defense outlay estimates.
11 May 1998	The Senate Armed Services Committee reports out the FY99 Defense Authorization bill with outlay policy

provisions. The legislation specifically addresses the WCF and asset sale provisions proposed by Senator Domenici. Assurances are provided by the authorization and Appropriations Committees that outlay estimate adjustments of \$700 million deriving from other accounts are applicable.

2 June 1998

The Senate Appropriations Committee reports out its FY99 Defense Appropriations bill. The bill includes a transfer of funds from O&M to the Pentagon Renovation Fund, reducing estimated FY99 defense outlays by \$190 million.

22 September 1998

The Senate and House pass the final FY99 Defense authorization bill incorporating WCF and asset sale policy provisions. These provisions reduce defense outlay estimates by \$1.3 billion and \$737 million, respectively.

25 September 1998

The Senate and House pass the final FY99 Defense Appropriations bill incorporating the transfer from O&M to the Pentagon Renovation Fund. This transfer reduces defense outlay estimates by \$190 million.

**Adjustment Summary:**  
(in billions)

FY99 Outlay Estimate Problem	\$3.700
WCF Adjustment	(\$1.300)
Administration Policy Assurances	(\$0.700)
Asset Sales Adjustment	(\$0.737)
Pentagon Renovation Adjustment	<u>(\$0.190)</u>
Residual Outlay Estimate Difference	\$0.773 <sup>7</sup>

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<sup>7</sup> This residual difference was determined to be "manageable." (Domenici, 1998).

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